Joint Legislative Study Committee on State Employee Compensation

2003 Annual Report

Joint Legislative Study Committee
On
State Employee Compensation

2003
ANNUAL REPORT

MEMBERS:

Senator Jay Tibshraeny, Cochair	Representative John Huppenthal, Cochair
Senator Barbara Leff	Representative Marian McClure
Senator Marsha Arzberger	Representative Meg Burton Cahill
Betsey Bayless	Carl Williams
Bill Bell	Leigh Cheatham
Cathy McGonigie	Shawn Nau
Kathy Peckardt	Linda Strock
Pam Tenney	Geri Davis
Jessica Anderson	Alan McGuire

JOINT LEGISLATIVE STUDY COMMITTEE
ON
STATE EMPLOYEE COMPENSATION

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Representative John Huppenthal, Cochair
Representative Marian McClure
Representative Meg Burton Cahill
Carl Williams
Leigh Cheatham
Shawn Nau
Linda Strock
Geri Davis
Alan McGuire

MEMBERSHIP:

- Three members of the House of Representatives, not more than two from the same political party and one designated as Cochair, appointed by the Speaker of the House of Representatives
- Three members of the Senate, not more than two from the same political party and one designated as Cochair, appointed by the President of the Senate
- Two members who are experts on employee compensation, appointed by the Governor
- Three members who are State agency directors, deputy directors or assistant directors, appointed by the Governor
- One member who is an employee of the state and a member of an employee association, appointed by the Governor
- One member from the university personnel system, appointed by the Executive Director of the Board of Regents
- One member who is an expert on employee compensation, appointed by the Speaker of the House of Representatives
- One member who is an employee of the State and who has at least ten years of State service, appointed by the President of the Senate
- Two members who are employees of the State and have at least ten years of State service, appointed by the Governor
- One member who is an employee of this State and who has at least ten years of State service, appointed by the Speaker of the House of Representatives

ESTABLISHMENT:

The Joint Legislative Study Committee on State Employee Compensation was created by Laws 1997, First Special Session, Chapter 3.

COMMITTEE CHARGE:

The purpose of the Committee is to: (1) study the various state personnel systems, state employee compensation and related issues, including salary, benefits, employee turnover and comparisons to other comparable public and private employers; (2) review all payroll deductions made from state employee salaries pursuant to A.R.S. 36-612; and (3) consider issues concerning state employee medical and dental insurance coverage, including issues relating to the size of the risk pool and the type of coverage provided to state employees. The Committee shall submit, on or before December 1 of each year, written recommendations on a long-term strategy for addressing state employee compensation.

TERMINATION:

December 31, 2003

PUBLIC MEETINGS:

The Committee met on September 10, 2003 for a presentation on the State's compensation ranking and market comparison. The Committee also discussed extension of the Committee, the state budget process and competitive compensation and alternative types of compensation.

The Committee met again on December 3, 2003 for presentations on total compensation, an update on the status of self-insurance and consideration of recommendations.

REPORT:

The Committee is required to submit, on or before December 1 of each year, written recommendations on a long-term strategy for addressing state employee compensation.

COMMITTEE RECOMMENDATIONS:

The Committee adopted the following recommendations:

- Introduce legislation to continue the mission of the Committee.
- Dedicate a permanent funding mechanism to move employees through their salary range.
- Renew the commitment to bring state pay to within five percent of market by 2009.
- Develop a model to give salary increases to State employees beginning in fiscal year 2006 with a 3 percent increase and increasing the percentage until the target amount of 95 percent of market is reached by fiscal year 2009.

The Committee recommendations are based on a memo from the Arizona Department of Administration (Attachment A).

ATTACHMENTS:

- Attachment A- Arizona Department of Administration Recommendations Memo
- Attachment B- Arizona Department of Administration 2003 Annual Advisory Recommendation
- Attachment C- Arizona University System 2003 Annual Personnel Report
- Attachment D- 2003 Total Compensation Study Presentation
- Attachment E- Self-Insurance Presentation
- Attachment F- Performance Based Incentive Program Presentation
- Attachment G- Minutes from the September 10th and December 3rd meetings

ATTACHMENT A

ARIZONA BOARD OF Regents

ANNUAL

PERSONNEL REPORT

FOR THE

ARIZONA UNIVERSITY SYSTEM

OCTOBER 2003

ARIZONA BOARD OF Regents

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September 30, 2003

The Honorable Janet Napolitano, Governor of Arizona
1700 West Washington
Phoenix, Arizona 85007

Re: Annual Personnel Report for the Arizona University System

Dear Governor Napolitano:

On behalf of Arizona's public universities and in accordance with A.R.S. 41-763.01, the Arizona Board of Regents submits its Annual Personnel Report.

Again this year, we have provided information about salaries, turnover, faculty retention, and overtime expenditures in the university system. As the report reflects, faculty and staff salaries continue to substantially lag behind the market and, by the end of FY 2005 we project an unmet salary need of approximately $179 million.

It is unfortunate that the university system's salary needs are presented this year against the backdrop of a struggling economy. Pay increases sorely are needed, and we very much would like to receive sufficient funding to satisfy the unmet salary need.

However, we also are fully cognizant of the seriousness of the current budget situation. Consequently, we are hopeful that the revenue picture soon will improve so that the competitiveness of employee salaries can be addressed. Our public universities are vital to the State's economy, and to preserve their strength it is essential for the universities to be able to recruit and retain talented faculty and staff. Our success is dependent upon our capacity to offer competitive salaries.

Thank you for your support of higher education.

Sincerely,

Linda
Linda J. Blessing
Executive Director

c: Regent Chris Herstam
University Presidents

ANNUAL PERSONNEL REPORT
FOR THE ARIZONA UNIVERSITY SYSTEM
OCTOBER 2003

BACKGROUND

A.R.S. 41-763.01 requires the Arizona Board of Regents (ABOR) to submit an annual report on university personnel to the Governor and the legislature. Accordingly, each university annually reviews and compares its employees' salaries with those salaries offered at peer institutions and in other relevant labor markets.

In November 1996, the Board adopted a three-year plan to *Restore Competitiveness to University Salaries*, designed to raise the average faculty salaries to the 50th percentile (median) of their peers and to raise the average salaries of all other employee groups to the market average. The plan has been the basis for the University System's salary requests in subsequent years.

In 1997 the legislature established the Joint Legislative Study Committee on State Employee Compensation. The committee was charged with studying state employee compensation and related issues including salary, benefits, employee turnover, various state personnel systems, and comparisons to other major public and private employers. In addition, the committee was charged with recommending to the Governor and legislative leadership a long-term strategy for addressing state employee compensation. The stated legislative intent was that *"competitive compensation be established by the end of fiscal year 2002-2003."*

The salary adjustments authorized by the legislature for FY 1998 through FY 2004 are shown below. For these seven fiscal years, the approved funding for salary increases has been much less than that required to bring university salaries to the market. When the Board adopted its 1996 plan to restore competitive salaries, university salaries already were well behind the market. The subsequent salary adjustments granted by the legislature have not been sufficient either to catch up with the market or to keep pace with upward salary movement in the relative labor markets since 1996.

SALARY ADJUSTMENTS AUTHORIZED BY THE LEGISLATURE
FY 1998 - FY 2004

FY 1998	2.5% across-the-board increase up to a maximum of $1,000 plus 2.5% merit increase pool
FY 1999	2.5% merit increase pool
FY 2000	2% merit increase pool
FY 2001	2% merit increase pool
FY 2002	$1,450 per FTE across-the-board increase*
FY 2003	$0*
FY 2004	$0

*The greater of 5% or $1,500 initially was authorized and later rescinded.

To stem the ever-widening gap, the universities reallocated funds, reduced programs, and left positions vacant to generate additional savings. In spite of the universities' efforts to increase salaries with alternative funding, employee salaries still significantly trail that of their peers and other relevant markets. These gaps continue to increase as competing markets provide larger annual salary adjustments.

For FY 2002 and FY 2003, ABOR requested $139 million for salary adjustments to enable the universities to catch up and keep up with their markets. Further, the Board requested an additional $20 million for special market adjustments to address the universities' most critical salary issues. For FY 2004, the universities have fallen further behind their peers and other labor markets, with the amount needed to catch up to market increasing to $157 million.

Although the legislature did not fund ABOR's FY 2002 and FY 2003 requests, it initially provided funding for salary adjustments amounting to the greater of five percent or $1,500 per FTE, and an additional $2 million for special market adjustments to address faculty "brain drain" at the universities. However, due to deteriorating economic conditions, these adjustments were either vetoed by the Governor or reduced by the legislature. Instead, an across-the-board increase of $1,450 per FTE was authorized effective June 8, 2002, with no funding provided for salary adjustments in either FY 2003 or FY 2004.

METHODOLOGY

Each university and the ABOR central office compare employee salaries with salaries at peer institutions and in other relevant labor markets. Each university compares its average faculty salaries to the average faculty salaries of its ABOR-approved peer institutions using the latest (Fall 2002) American Association of University Professors (AAUP) data. For all other employee groups, the universities and the ABOR central office compare average salaries with average salaries in appropriate labor markets using the most recent, relevant, and available data.

The universities calculate the difference between average market salaries and average university salaries when direct comparative compensation data is available. For jobs without direct comparative data, the universities use the distance from market for similar employee categories. To calculate unmet salary needs, the universities determine the amount required to raise average faculty salaries to the 50th percentile of their peers and to raise other staff salaries to the average of their respective markets.

The salary surveys used in the calculations include:

- American Association of University Professors (AAUP)
- Association of American Medical Colleges
- Association of American Universities Data Exchange
- State Higher Education Executive Officers (SHEEO) Staffing and Salary Survey
- Council on Teaching Hospitals Housestaff Stipends
- Association of Research Libraries
- Joint Governmental Salary Survey (JGSS)
- College and University Professional Association for Human Resources (CUPA - HR)
- Other local and job-specific survey data

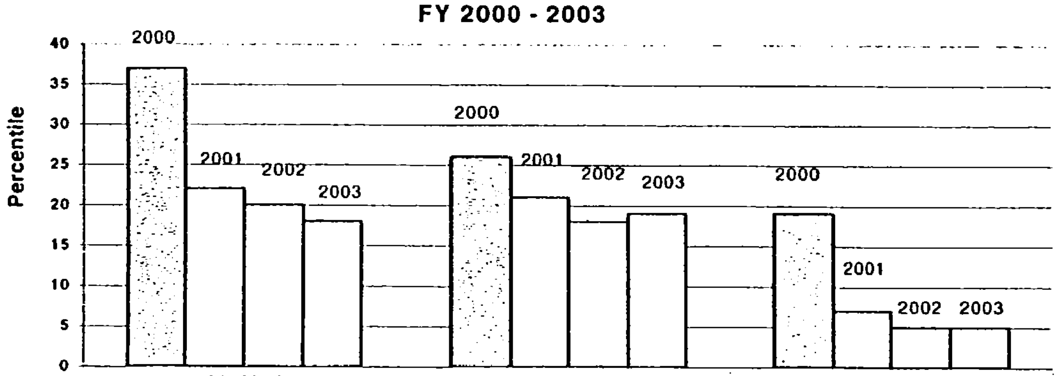
MARKET COMPARISONS

FACULTY SALARIES

Arizona's public universities compete with hundreds of other public and private universities throughout the country to attract and retain talented faculty. The competitiveness of salaries is quite often the single most important factor in determining whether an individual accepts employment or stays with Arizona's universities. To assess how competitive Arizona's salaries are compared to the national marketplace, the universities calculate percentile rankings, comparing faculty salaries in Arizona to those in peer institutions. These comparisons include all ranked faculty--professors, associate professors, and assistant professors.

The faculty percentile rankings for ASU Main, UA Main, and NAU for the last four years are reflected in the chart below. For all three universities, the percentile rankings have declined over this period. Specifically, ASU Main's percentile ranking dropped from 37 to 18; UA Main's dropped from 26 to 19; and NAU's dropped from 19 to 5. Although not reflected on the chart, the percentile ranking for ASU West declined over these same years from 26 to 2. The peer universities are listed in Exhibit 1 at the end of this report.

ARIZONA'S PUBLIC UNIVERSITIES'
FACULTY SALARY PERCENTILE RANKINGS
FY 2000 - 2003



	ASU MAIN	UA MAIN	NAU
2000	37	26	19
2001	22	21	7
2002	20	18	5
2003	18	19	5

The FY 2003 percentile rankings clearly show that the large majority of the comparator universities pay higher average salaries to their faculty than each of Arizona's universities, demonstrating that Arizona's standing is not competitive. Specifically:

- 22 of the 28 comparator universities pay higher average salaries than ASU Main and UA Main;
- 15 of the 17 comparator universities pay higher average salaries than NAU; and
- The average salaries are as much as 25%, 24%, and 20% higher than ASU, UA, and NAU, respectively.

MARKET COMPARISONS

In addition to salary information, the annual AAUP survey provides information regarding the value of faculty benefits. This enables comparisons of total compensation, i.e., the combined value of salary and benefits, and provides additional insight into the competitiveness of the University System.

When total compensation is calculated for FY 2003, the percentile rankings for ASU and UA drop significantly, and the percentile ranking for NAU increases slightly. Specifically, ASU Main drops to the 10th percentile while ASU West drops to the bottom of the rankings. UA Main's ranking drops to the 14th percentile, and NAU's increases to the 6th percentile.

Whether looking at average salaries or total compensation, the three universities are not positioned to compete seriously for faculty in the national arena. Moreover, the universities are not adequately equipped to attract or retain faculty of the highest national quality -- those educators, researchers, and scientists who are foremost in their fields. Such individuals, who are able to raise the quality and stature of the universities' programs, can and do command top dollar. Accordingly, Arizona's public universities must have the capacity to meet the salary requirements of these scholars and pay beyond the 50th percentile to attract and retain them.

STAFF SALARIES

Much like faculty salaries, average staff salaries substantially lag behind the market, and salary increases for these employees have been insufficient to catch up and keep pace with the market.

The salary adjustments initially approved for FY 2002 and FY 2003 would have resulted in a very positive and material gain for staff, especially for employees at the lowest salary levels who earn less than $30,000 annually. These employees would have received a minimum annual increase of $1,500, thereby increasing their base salary by more than 5% during each of these two years.

Unfortunately, the rescission of these salary increases and the substitution of a $1,450 across-the-board increase for only one year forestalled any significant headway. For many staff members, the $1,450 salary adjustment did little to enhance their situation since it largely was offset by an increase in health insurance costs borne by employees in FY 2002. Although health insurance premiums did not increase in FY 2004, employees enrolled in the Arizona State Retirement System saw their employee's contribution more than double from 2 percent in FY 2003 to 5.2 percent beginning July 2003. The increase in the contribution rate has the effect of a pay cut for many employees.

The table below reflects the percentage increase required for average staff salaries at each university and the ABOR central office to reach market.

PERCENTAGE INCREASE REQUIRED TO REACH MARKET FOR CLASSIFIED AND OTHER STAFF

	CLASSIFIED STAFF	ALL OTHER STAFF
ASU MAIN	18.2%	16.7%
ASU WEST	22.0%	20.4%
ASU EAST	18.2%	17.5%
NAU	14.5%	8.6%
UA	18.5%	15.4%
ABOR CENTRAL OFFICE	13.3%	18.1%

MARKET COMPARISONS

UNMET SALARY NEEDS

Using the methodology described earlier in this report, each university calculated its unmet salary needs for FY 2005, which included a projection of market movement.

As shown in the chart below, university employees' salaries will remain considerably lower than those at peer institutions and in the other relevant markets at the end of FY 2005. An unmet general fund salary need of approximately $179 million, including ERE, is projected in order for the universities to catch up with the market.

In 1996 when the University System developed its multi-year plan to restore salary competitiveness, the universities estimated that it would cost approximately $47.5 million to reach the 50th percentile/market average. By June 30, 2005, the cost to raise the average salaries of current faculty and staff to the targeted levels will escalate to $179 million, and the situation will worsen dramatically if salary increases are not provided in the next few years. If the market continues to move as it has in the past, from 4% to 5% a year, the unmet salary need will increase to approximately $200 million by the end of FY 2006 and to approximately $240 million by the end of FY 2007.

PROJECTED UNMET SALARY NEEDS FOR THE UNIVERSITY SYSTEM AS OF JUNE 30, 2005

	UNMET SALARY NEEDS
ASU MAIN	$68,636,800
ASU WEST	9,218,700
ASU EAST	3,215,600
NAU	33,316,000
UA MAIN	54,351,400
UA HEALTH SCIENCES CENTER	9,986,600
ABOR CENTRAL OFFICE	297,600
SYSTEM TOTAL	$179,022,700

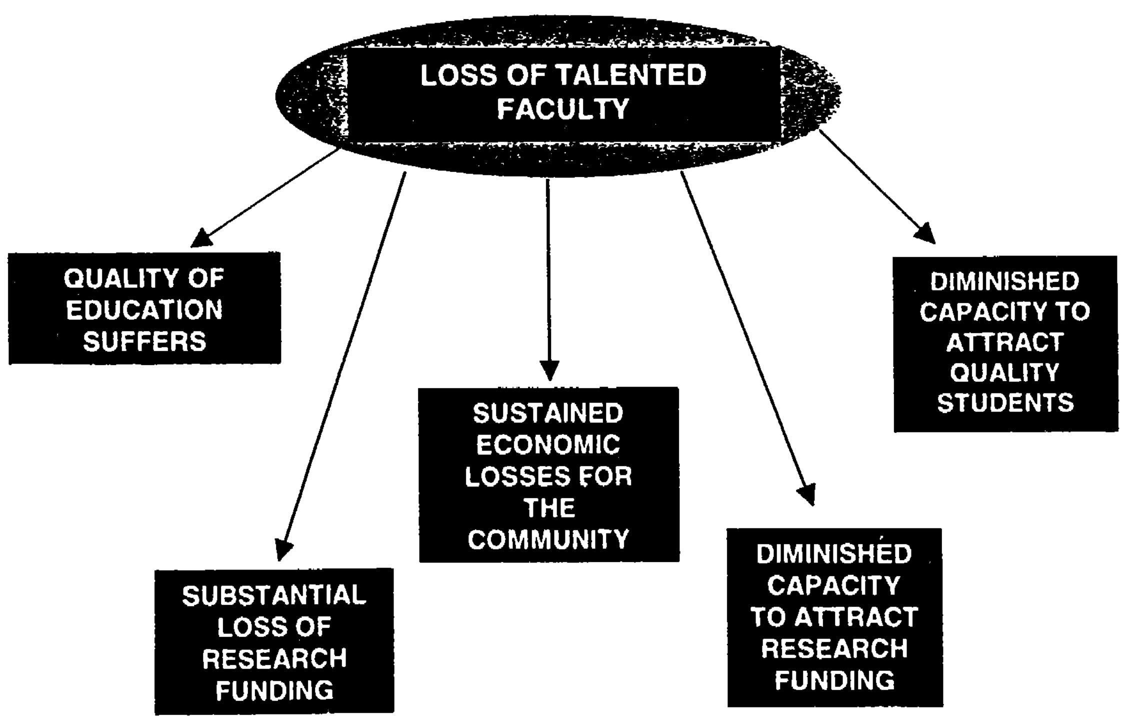
FACULTY RETENTION

Faculty retention again was a significant problem for Arizona's universities in FY 2003. Notwithstanding the economic situation throughout the country, an increasing number of faculty members left for positions in other organizations, often receiving much higher salaries and benefits and exceedingly better resources for research and program development.

In Arizona, 39.5 jobs are created for every $1 million in research contracts and grants to colleges, universities, and professional schools, according to the U.S. Commerce Department's most recent economic analysis.

As illustrated below, the universities and the communities they serve suffer dramatically when faculty leave Arizona. Top scientists and researchers may take millions of dollars in grants and contracts with them when they depart, setting university progress back by years and diminishing the university's ability to attract additional research funding. Moreover, when the universities' research efforts are curtailed, the economic consequences are substantial.

Equally important, educators who are leaders in their fields contribute markedly to the quality of the educational experience for the many thousands of students in the Arizona University System. When the universities lose these leaders, the students lose the immeasurable opportunity to learn from them.



The average turnover rates for all categories of faculty at ASU Main, ASU West, and ASU East are 9.7%, 9.9%, and 7.8%, respectively. At the UA the faculty turnover rate is 10.0% at the Main Campus and 9.7% at the Arizona Health Sciences Center. The faculty turnover rate at NAU is 10.1%.

> In the past 12 months, approximately 500 faculty members left the University System. It will take years to replenish and rebuild the reservoir of talented and distinguished faculty and intellectual capacity that the universities worked so long and so hard to create.

While this year's turnover rate in the Arizona University System is a concern in and of itself, the cumulative effect of the turnover over the past several years is much more disturbing. In the past 12 months, approximately 500 faculty members left the University System. The continuing loss of faculty weakens the universities, undermines programs and research efforts, and threatens the quality of the educational experience.

FACULTY RETENTION

To provide additional perspective, the three universities developed brief profiles of their faculty retention problems. In the next few pages, each university presents an array of statistical information and illustrative examples of the program implications due to the loss of its faculty. The information pertains to tenured and tenure-track faculty and academic professionals who voluntarily considered leaving the universities during FY 2003. Retirements and other reasons for separation are not included in the analysis.

ASU FACULTY RETENTION
FY 2003

COLLEGES IMPACTED

Retention issues occurred at all three Arizona State University campuses and in all colleges at ASU Main with the exception of the College of Fine Arts.

KEY POINTS

- During FY 2003, 53 tenured/tenure-track faculty and academic professionals voluntarily left Arizona State University. This number resigning is considerably lower than during FY 2002 when 78 individuals left for employment elsewhere. There are two major reasons for the decrease in number of faculty leaving the university.

  - ASU was particularly aggressive in identifying funds to outbid competitor universities when highly valued and marketable faculty members were the target. Attractive counteroffers were made, and many faculty elected to stay.

  - ASU, through the deans and department chairs, identified faculty (about 10%) who were top achievers and marketable and whose loss, if they chose to leave, would seriously damage the institution. Identified faculty members were proactively awarded substantial merit and market increases in salary so they would not be tempted to seek employment elsewhere. The dollars for salary increases (roughly $2 million) came from reallocating institutional dollars.

- In spite of ASU's best efforts, many individuals chose to leave the university and explicitly expressed that salary entered into their considerations. Several individuals shared details of offers made to them by other institutions. Competing institutions offered salary increases that were from $10,000 to $35,000 higher than their ASU salaries. One individual went to industry where his salary doubled. Other universities competing for ASU faculty included the Universities of Missouri, Colorado, California, Illinois, Tennessee, Michigan, Northwestern, and Purdue, to name a few.

- Although ASU is proactive in its retention efforts and must be in order to survive, this mode of action also creates several negative consequences that will soon need addressing. Morale among the 90% of faculty who have not received significant salary increases is at risk, and the student-to-tenured/tenure-track faculty ratio continues to increase as ASU uses empty faculty positions to address salary problems.

EXAMPLES OF PROGRAM IMPACTS

ASU FACULTY RETENTION

- The negative programmatic impact of below-market salaries is pervasive at Arizona State University. Loss of faculty to competitor institutions coupled with budget cuts, significant enrollment increases, and efforts to augment some faculty salaries by not filling empty faculty positions is stretching the current faculty resources to the maximum. Over the past two years, ASU has had to accommodate 7,500 new students and yet faculty numbers remain relatively flat. Quality is threatened as indicated by student-to-faculty ratio. ASU's student-to-tenured/tenure-track faculty ratio has now reached 32:1, 36:1, and 31:1 on the Main, West, and East campuses, respectively. This compares to 30:1, 24:1, 21:1, respectively, only four years ago and is much higher than ASU's peers. The eroding number of core faculty is affecting all programs. Not only are temporary faculty and graduate students teaching more and more students, class size is also increasing.

- ASU is mandated by statute to double the output of Bachelor-prepared registered nurses over the next five years, and to do this in the absence of new state funding. The number of core faculty in the College of Nursing has decreased by 15% over the last five years. ASU is having difficulty replacing departing faculty because of the scarcity of nursing faculty on the market and its inability to compete with other institutions for this scarce resource due to salaries that are not competitive. ASU faces two problems, retaining current faculty who are underpaid and attracting new faculty. At this time, ASU is unable to accept all qualified student applicants who wish to enter the professional nursing program. To fix this problem and to fulfill the mandate from the state will require investments from the students, the state, and the health care industry.

- Arizona has a critical need for a substantial growth in the number of K-12 teachers. It is estimated that by 2010, Arizona will need at least 11,384 additional teachers. ASU is committed to increasing its output of early childhood educators and K-12 teachers by 100% and 50%, respectively, with the production of new teachers growing from 1,000 to 1,500 per year. In order to meet this commitment, ASU must ramp-up the faculty and staff infrastructure, requiring sacrifices throughout the institution. Because ASU has been forced to cannibalize vacant faculty positions to meet salary needs of key faculty and staff, the number of faculty members in the College of Education has not grown significantly for many years. This practice cannot continue if ASU is to keep its promise to help meet Arizona's critical need.

- ASU has pledged to do its part in helping to diversify the economy by building its research infrastructure and, over the next five years, by doubling the external dollars brought into the state through its research and creative activities. To do this, ASU must retain the talent it has assembled as well as attract new talent to the university. This will require making salaries competitive and creating university and community environments sufficiently attractive to draw top scholars into the state.

NAU FACULTY RETENTION
FY 2003

COLLEGES IMPACTED

All Northern Arizona University colleges experienced turnover problems with the exception of the College of Hotel and Restaurant Management. In particular, the colleges of Health Professions, Education, and Arts and Sciences experienced serious losses of tenured and tenure-track faculty.

KEY POINTS

- During FY 2003, 29 faculty members resigned compared to 23 in FY 2002. Tenured or tenure-track faculty members comprised 62% (18 out of 29) of the resignations.
- For those cases where information was available on outside salary offers, tenured or tenure-track faculty were offered, on average, a 42% increase in salary.
- For those cases where information was available on counteroffers, NAU offered, on average, 17% more in salary in an attempt to retain those faculty. In only two cases were tenured or tenure-track faculty members retained.
- NAU lost faculty to public and private universities and school systems. Faculty members were recruited away by the University of Pennsylvania, University of New Zealand, University of Utah, Cleveland State University, Fort Lewis College, Indiana University, Abilene Christian University, Central Michigan University, and Las Vegas Public Schools.
- Of the tenured or tenure-track faculty members who left, salary reasons were attributed to 52% of the departures. The other factor cited most frequently was career-related opportunities (47%).
- Low faculty salaries not only affect retention, but departments report that the salaries they can offer limit their ability to fill faculty vacancies. While other universities are able to offer allowances and equipment as recruitment incentives, many NAU departments do not have the resources to offer such incentives.

EXAMPLES OF PROGRAM IMPACTS

- Early Childhood Education was especially affected in FY 2003 with the loss of three faculty members. For example, an assistant professor, earning about $43,000 a year, was offered a Director position in the Maryland public schools system at more than $70,000. There is no way for NAU to compete with such large salary offers, and given that this was the third loss, NAU may need to reconsider whether to continue to provide this educational program.

- Another area hurt in FY 2003 was Educational Technology. One professor had the opportunity to increase his salary by $20,000 to move to a technology Director position at another university. A counteroffer was made, but it was not even close to what the other university offered. His departure leaves NAU's master's degree program in a difficult position due to the number of sections that will have to be covered by part-time faculty. NAU anticipates further difficulties in recruiting a replacement due to the increasing salaries that technology educators command.

- The department of Nursing lost seven faculty members, including three tenure-track faculty and one tenured faculty member. These individuals left for various reasons; however, salary and career reasons were cited as the most frequent causes. NAU-Yuma lost a nursing faculty member position funded by Yuma Regional Medical Center. The losses affect NAU's teaching, research, and grant opportunity potential.

UA FACULTY RETENTION
FY 2003

COLLEGES IMPACTED

The University of Arizona continues to manage an ever-increasing number of retention cases every year. Since FY 2000, there was a 61% (51 cases) increase in recruitment offers received by faculty from outside institutions and agencies. As in previous years, every college negotiated retention cases, except UA South with a relatively small number of tenure-track faculty. The College of Fine Arts, the University Libraries, and Optical Science negotiated retention cases with 10% of their faculty, while the colleges of Social and Behavioral Sciences and Law saw the number of retention cases climb even higher to 20%. Arizona's loyalty and sunshine taxes can no longer compete with steep market competition for quality faculty.

KEY POINTS

- In FY 2003, the University was again able to retain more faculty than were recruited away, with a retention rate of 55%, or 74 cases out of 134. But one must remain cautiously optimistic. The overall retention rate dropped six points from last year with the number of faculty recruited away growing. The positive trend has begun to reverse itself with the University again struggling to retain one of its most important assets, faculty. The continued recession resulting in decreased state support is continuing to erode the competitiveness of salaries in Arizona.

- The retention rates for women have improved since FY 2000, while the retention rates for men and underrepresented groups took a sudden downturn in FY 2003. For the first time in five years, the retention rate for women (58%) outpaced that for men (53%). In FY 2003, the retention rate for men dropped 10 points while the retention rate for underrepresented groups dropped 17 points.

- Administration and colleges are working with faculty to lessen the impact of below-market salaries as much as a deteriorating budget will allow. For those cases where information was available on outside salary offers, faculty members were offered, on average, 34% more in salary to recruit them away. With aggressive and creative retention efforts, the University has been able to forestall many losses. For those cases where information was available on UA counteroffers, the UA offered, on average, 21% more in salary in an attempt to retain faculty – up from last year's 15%. Overall, the UA expended $876,000 in salary alone to retain faculty. This dollar outlay would have been over $1.1 million in salaries alone if the UA had been able to retain everyone. This "out-of-pocket" expenditure coupled with budget cuts adds an extra burden on colleges.

- It is important to assess the magnitude of offers, but it is also important to gauge the quality of UA faculty as determined by the market. Top-tier, prestigious public and private universities and industry recruited UA faculty heavily during FY 2003. Faculty moved on to Brigham Young, Cambridge, Chicago, Duke, Harvard, Johns Hopkins, Notre Dame, Stanford, St. Mary's, University of Southern California, and Vanderbilt Universities as well as to the private sector, including Celera, Eli Lilly, and Los Alamos National Laboratories. Examples of public universities include Colorado State, Florida State, Georgia Institute of Technology, George Mason, Louisiana State, Maryland, Michigan, Minnesota, North Carolina, Pennsylvania State, Rutgers, Syracuse, Texas/Austin, Toronto, Utah, and Washington. Many faculty and their families moved to the higher cost-of-living state of California following favorable recruitment offers from the Universities of Southern California, Irvine, Merced, and Riverside.

- The University of Arizona continues to be a training ground for better-financed institutions, with the UA able to recruit outstanding faculty but unable to retain them. In FY 2003, those seeking outside offers were five years younger and had four years less experience than the UA faculty-at-large.

- With shrinking state funds, one department has offered faculty a 10% salary increase on their grants and contracts. Even these efforts are insufficient to match market offers. Another concern from a University-wide perspective is that the institution is utilizing internal funds for faculty retention to the detriment of the medium-term ability to cover costs associated with student demand for both general education and major courses.

EXAMPLES OF PROGRAM IMPACTS

- The faculty recruited away from UA in FY 2003 generated $63 million in sponsored research over the last three years, and the faculty that UA was able to retain generated $39 million. The University's continuing retention efforts were critical this past year, but there were cases where UA could not even come close to the market. The University was unable to retain a faculty member in engineering who generated $23 million in research alone over the past three years.

- At a time when there is a severe nationwide shortage of nurses, the College of Nursing faculty are being recruited by outside institutions. A departing faculty member in Nursing was offered a salary supplement in addition to funds for development of her research program. This loss will leave a hole in the college's ability to cover the area of health care costs in the Ph.D. nursing program, necessitating the college to look to independent contractors until the gap can be filled.

- Salary compression continues to be a common theme but with an added twist. Faculty loyal to the institution are finding it difficult to remain at the UA, not only because of salary but professional development reasons as well. Faculty are beginning to feel that they can no longer meet their original hiring goals because of the continuing lack of resources for program and research development. Faculty are being offered far more than increased personal compensation by recruiters. They are being offered research-related resources as well. This is evidenced by the perks offered to departing faculty, such as housing allowances, start-up packages, signing bonuses, endowed chairs, new facilities, substantial summer support, and other benefits too rich for the UA to match.

- During FY 2003 the University lost another internationally recognized and highly productive research team. A 24-member research group in optical science left for the Georgia Institute of Technology – all for better opportunity. This faculty member was not only a world-renowned researcher but also an excellent teacher who took the time to mentor students. Upon signing, the faculty member was offered an initial 30% salary increase, $30,000 signing bonus, $400,000 start-up package, and funds for more research staff. In addition, Georgia Tech paid the personal moving expenses for the entire research team (including students) and lab. The lab move alone cost well over $200,000. In January 2004, the faculty member will receive a 10% salary increase upon becoming the administrator for the Center for Organic Photonics and Electronics and will receive a 15% salary increase when promoted to full professor, also in 2004. This was a significant loss not only for the University but the state as well. The loss of applied research in optics will be difficult to replace and expensive to rebuild.

- A departing College of Social and Behavioral Sciences faculty member's motivation for leaving included a desire for more interdisciplinary opportunities. Also, the faculty member wanted to move to a state with less budgetary uncertainty. This loss will greatly reduce the department's high visibility in that discipline.

CLASSIFIED STAFF TURNOVER

CLASSIFIED STAFF TURNOVER

Classified staff turnover is a chronic problem, with the universities losing far too many staff in positions that are critical to the operation and success of the institutions. In the past 12 months alone, nearly 1,700 classified staff members left their employment at Arizona's universities. Areas affected by staff turnover include information technology, libraries, public safety, health services, administrative support, and student services, to name a few.

Turnover is extremely disruptive and very costly. Each time a staff member leaves, the universities are faced with the advertising, interviewing, and training costs associated with hiring a new employee. In addition, many indirect, difficult-to-quantify costs exist, such as decreased productivity, loss of quality, and lost work hours when the job is vacant and while the new employee learns the job.

A review of the literature reveals that the cost of turnover is generally estimated at one to two times the salary of a departing employee. With such high costs, the persistently high turnover rate in the universities is a significant concern.

The chart below depicts the classified staff average turnover rate in the university system.

CLASSIFIED STAFF
AVERAGE TURNOVER RATE

	TURNOVER PERCENTAGE
ASU MAIN	13.9%
ASU EAST	10.1%
ASU WEST	15.0%
NAU	15.9%
UA MAIN	15.3%
UA HEALTH SCIENCES CENTER	22.1%
ABOR CENTRAL OFFICE	11.8%

OVERTIME PAY

A.R.S. 41-763.01 requires the Board of Regents to report on the universities' overtime pay. The overtime expenditures of each university and the ABOR central office during FY 2003 are delineated in the chart that follows.

FY 2003
OVERTIME PAY REQUIREMENTS

	COSTS
ASU MAIN	$206,200
ASU WEST	$87,000
ASU EAST	$21,600
NAU	$261,800
UA MAIN	$231,500
UA HEALTH SCIENCES CENTER	$600
ABOR CENTRAL OFFICE	$0

EXHIBIT 1

UNIVERSITIES' PEER INSTITUTIONS

ASU/UA (combined)

University of California – Berkeley
University of California – Los Angeles
University of Cincinnati
University of Colorado – Boulder
University of Connecticut
University of Florida
Florida State University
University of Illinois – Urbana
University of Illinois – Chicago
University of Iowa
University of Kansas
University of Maryland – College Park
University of Michigan – Ann Arbor
Michigan State University
University of Minnesota – Twin Cities
University of Missouri – Columbia
University of Nebraska – Lincoln
University of North Carolina – Chapel Hill
Ohio State University
University of Oklahoma
Rutgers, State University of New Jersey
Temple University (Pennsylvania)
University of Texas – Austin
Texas A&M University
University of Utah
University of Virginia
University of Washington
University of Wisconsin – Madison

NAU

Ball State University (Indiana)
Bowling Green State University (Ohio)
California State University – Fresno
University of Central Florida
University of Delaware
George Mason University (Virginia)
Miami University of Ohio
University of Minnesota – Duluth
University of Montana
University of Nevada – Las Vegas
University of Nevada – Reno
University of North Dakota, Main
Oakland University (Michigan)
Ohio University, Main
Old Dominion (Virginia)
University of Vermont
University of Wyoming

BETSEY BAYLESS
DIRECTOR
ARIZONA DEPARTMENT OF ADMINISTRATION

MEMORANDUM

TO: Senator Tibshraeny, Co-Chair
Representative Huppenthal, Co-Chair
Joint Legislative Study Committee on State Employee Compensation

FROM: Betsey Bayless, Director, Arizona Department of Administration
Kathy Peckardt, Assistant Director, Human Resources Division

DATE: November 26, 2003

RE: Recommendations

The Arizona Department of Administration would like to submit the following information for the consideration of the Committee as recommendations to address the issue of State Employee Compensation. We fully appreciate the challenges faced by the Legislative and Executive branches in addressing the fiscal issues of the State. However, we also are faced with a significant gap in the total compensation package offered to state employees – a gap that has grown every year. This issue must be addressed, and although we cannot completely close this gap, we must act immediately to at least begin narrowing the difference in compensation between our state employees and other public and private sectors.

D

There are several indicators that the economy is improving across the nation and at home here in Arizona. Although employment lags the economy, we anticipate the employment situation will also recover. The State has experienced annual turnover rates of 15-16%, in recent years, well above turnover rates in other public and private organizations. There is no reason to believe the exodus of talented employees will not worsen as the economic recovery continues, eroding the State's ability to provide critically needed services to our constituents.

We offer the following three significant and concrete actions for your consideration.

Increase Overall Salary

The ADOA 2003 Advisory Recommendation lists three different models to address the overall salary issues faced by state employees (see attachment). Model#3 offers a delayed approach whereby reduced funding would be necessary in the short-term and higher levels of funding would be required in later years. If this approach is pursued, about $25 million would be required in FY 2004.

Establish a Performance Recognition Fund
There is a significant body of research literature that demonstrates recognition is a powerful motivator that has the potential to significantly impact turnover/retention and employee productivity. The 2003 Advisory Recommendation includes a suggestion (attached) to dedicate an additional $6 million for the purposes of establishing a performance recognition fund. There are a variety of means by which this fund could be administered, and the Human Resources Division of ADOA would establish appropriate guidelines.

Create a Mechanism to Move Employees through their Salary Range
Nearly 50% of state employees are in the lower quartile of their salary range. There currently is no mechanism to provide increases in salary for individuals that would allow them to move up through their range. We suggest the Committee address this issue and challenge the Legislature to dedicate a permanent funding mechanism to ensure that as an employee gains experience and tenure (and achieves acceptable performance ratings) they have a formal process that ensures movement through the salary range. Again, the Human Resources Division will administer this program and provide the specific framework.

Call for Action
The State is clearly in a very challenging situation, called upon to address a wide variety of very significant funding issues. There are many programs and services that have not received adequate funding. The Legislature must realize, however, that ALL programs and services provided by the State are ultimately entirely dependant upon the efforts and dedication of individual state employees. We must be able to attract and retain employees of sufficient caliber to provide these services. Decisive action is called for at this time – to set in motion the long-term strategies that will gradually bring state employee compensation back to a competitive position.

Attachment (pages excerpted from ADOA 2003 Advisory Recommendation)

Compensation Options

There are three basic components of any organization's compensation plan: to attract new employees, to retain current employees, and to motivate employees to consistently perform and contribute at their highest levels.

For the State's compensation plan(s), the lack of funding has seriously eroded the ability to fulfill these objectives. The following information identifies several options to address the objectives. Options include three possible models for improving the State's market position and an approach for addressing critical market positions, as well as other possibilities such as performance recognition and non-compensation based options.

IMPROVE THE STATE'S MARKET POSITION

In the Annual Advisory Recommendation for 2002, the Arizona Department of Administration offered three models for improving the State's market position to be at 95% of the overall market salary rates. These three alternatives have been reviewed and updated.

Model #1:
Since 95% market parity was the five-year plan implemented in 1998, this objective has been interpreted as a target the State still hopes to achieve. In order to achieve this goal in the next year, **$181,559,710** is the amount necessary to reach the target.

Model #2:
A second cost estimate, utilizing a five-year implementation strategy, has been developed. This proposal starts with FY 2004 and ends FY 2009.

FY 2004	$ 52,954,916
FY 2005	$ 55,179,022
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Total	**$287,969,548**

Because the State is in a "catch-up" mode, 4.2% is necessary each year. This reflects the amount required to match the projected market movement over the five-year period, as well as the 16.3% deficit that needs to be erased starting in 2004.

Model #3:
Building on the concept proposed in Model #2, an approach that further reduces the initial funding requirement but keeps the State on track for achieving the target. This approach simply defers the funding requirements to the end of the five-year plan period when the revenue stream may be more favorable.

FY 2004	$25,216,626	2.0%
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Total	**$287,021,960**	

ESTABLISH A PERFORMANCE RECOGNITION FUND

Recognition can be a more powerful motivator than money.

The idea of recognizing top performers is very important and should not be overlooked when funding is scarce; in fact, it may be more important in these times. There needs to be a way to reward those who make significant contributions in their respective areas of expertise and are obviously outstanding performers. Following is a recommendation to address this need at minimal expense:

- Studies have repeatedly confirmed that employees rank recognition higher than financial rewards, which is the premise for recommending a "Performance Recognition Fund" be established at the agency level for top performers.
- Performance pay will be lump sum payments (not added to base salary).
- Funding can be limited to less than one percent of the agency's base annual payroll.
- Agency managers will be allocated a portion of the funds to award as they deem appropriate.
- Guidelines will be given to managers to assure consistency in the performance criteria and selection methodology.
- This program will be performance driven, not an incentive plan similar to "PIPP."

The cost of a performance fund can be relatively insignificant when compared to the total payroll, but for purposes of illustration a very simple formula is suggested. Starting with the premise that a 5% lump sum award is significant in the eyes of employees, and estimating that the State wants to target 10% of the employee population for an award, the funding for all agencies, state wide is $6 million.

OFFER NON-CASH COMPENSATION OPTION

With the understanding that no budget dollars exist for base salary increases, there are other alternatives that should be considered for recognizing State employees' contributions and their loyalty to State service. Following is one example of a high value, non-cash benefit.

Paid Holiday Added

Based on the average number of paid holidays for the twenty-five Western state governments, Arizona's ten paid holidays is one day short of the average. The common day missing from Arizona's schedule is the day after Thanksgiving; another option is a "floating" holiday, or personal business day. Many of the other states have local holidays not recognized across the nation, such as Texas Independence Day, Mardi Gras Day, LBJ's Birthday, or Pioneer Day.[8]

According to a survey of the State's human resources managers, time off is a very desirable non-cash commodity for the following reasons:

- Two income families have little time for family or personal obligations.
- Stress induced by hectic schedules leads to health problems that manifest in higher medical costs and absenteeism.
- Emotional stress due to guilt over not being available for family.

[8] 2002 Central States Compensation Association Survey

ATTACHMENT B

State of Arizona

Janet Napolitano
Governor of Arizona

Betsey Bayless
Director, Department of Administration

Arizona Department of Administration
HUMAN RESOURCES SYSTEM
2003

ADVISORY RECOMMENDATION

ARIZONA DEPARTMENT OF ADMINISTRATION
2003 ANNUAL ADVISORY RECOMMENDATION

GENERAL

Last year the Annual Advisory Recommendation was prepared in the midst of a sluggish economic situation and uncertainty as to when, and to what extent, the economy would recover. The 2002 Recommendation noted the challenge the state of Arizona would face as the demand for services continued to grow. This year, the economy remains slow and the budget situation has worsened, as State agencies struggle to provide meaningful services to more citizens with less funding available. The employees of the State of Arizona continue to provide services to their fellow citizens while their own salaries continue to lag behind in the market.

FINDINGS

The average salary for covered Arizona State employees as of June 30, 2003 was $31,859. According to data from the last ten years, State employee salaries continue to trail those in the public and private market place.

STATE OF ARIZONA vs. SALARY SURVEY RESULTS

The following information compares State salary averages to those of other organizations using benchmark classifications to compare pay practices. The information is divided into three segments that focus on geographical comparisons and a specific analysis of the major city governments in Arizona. The intent is to provide the best picture of the State's market competitiveness as we attempt to attract and retain valued employees.

Overall variances in the salary surveys show a sustained trend below market for the State. Both the Joint Governmental Salary and Benefits Survey (JGSS)[1] and the Western States Salary Survey [2] show:

- State employee salaries remain below market.
- Salary range minimums remain below market.
- Thirty-three survey benchmark classes have average salaries more than 25% below market average salaries (Total survey benchmarks: JGSS, 128; Western States, 133).

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[1] The JGSS, conducted annually, compares State of Arizona salaries to public and private employers in Arizona. The 2003 survey, conducted in March, had 188 participants.

[2] The Western States Salary Survey, conducted annually, compares State salaries to other public employers – cities, counties, and states -- in 12 western states. The 2003 survey, conducted in March, had 28 participants.

Western States Salary Survey

The annual *Western States Salary Survey* is a companion survey to the *Joint Governmental Salary Survey*, providing benchmark job comparisons at the higher level professional classifications in government, e.g., State Auditor, Park Manager, and Grants Coordinator. Following are the key measurements:

	2002	2003
State Average Salary vs. Market Average Salary	-26.3%	-21.3%
State Midpoint vs. Market Average Salary	-13.5%	- 8.5%

Although the State is still behind the market, the State's position did improve with the general increase granted to all State employees in June 2002. A chart detailing the results of the survey is provided in Attachment #1.

Joint Governmental Salary and Benefits Survey (JGSS)

This survey is the Department of Administration's most widely referenced tool for assessing the Arizona market position and represents a broad cross section of public and private employers of all sizes. The degree to which the State salaries are below market has not changed since 2002.

It should be noted that a technical correction has been made to more accurately show the State's relationship to the market. Specifically, the classification of "Habilitation Technician"[3] has consistently been used as a benchmark, but in the last two years a dwindling number of employers have used it, making comparisons less reliable. Therefore, these charts indicate the percentages with and without the Habilitation Technician classification.

	2002	2003
State Average Salary vs. Market Average Salary	-16.4%	-16.3%
State Midpoint vs. Market Average Salary	- 5.8%	- 6.3%
Without Habilitation Technicians:		
State Average Salary vs. Market Average Salary	-19.5%	-19.0%
State Midpoint vs. Market Average Salary	- 9.4%	- 9.0%

Arizona City Governments vs. State Salaries

A comparison of State salary averages to average salaries in nine Arizona cities[4] shows that the State lost more market position. In 2003, the State is significantly behind the average of these cities' salary programs: -33.2% for 2002, and -35.4% for 2003.

The JGSS has continuously exceeded the State employee average salary in double-digit percentages since 1993, when it was 19.6%. It has not been in single digits since 1988, when it was 7.2%. A history of the JGSS market variance is shown in Figure 1.

[3] The Habilitation Technicians work with developmentally disabled persons in a structured program, training clients in vocational, socialization and independent living skills.

[4] Information from JGSS, 2002 and 2003, including Avondale, Chandler, Flagstaff, Glendale, Goodyear, Phoenix, Scottsdale, Tempe, and Tucson.

Figure 1

History of JGSS Market Variances

Year	Average Actual Salary	Average Salary Range Midpoint
1988*	-7.2%	-0.6%
1989	-13.9%	-4.8%
1990	-13.9%	-3.9%
1991	-19.6%	-7.5%
1992	-22.5%	-9.3%
1993	-20.6%	-12.9%
1994	-22.5%	-10.6%
1995	-22.5%	-9.4%
1996	-25.7%	-12.2%
1997	-22.5%	-9.9%
1998	-17.5%	-7.5%
1999	-11.5%	-6.8%
2000	-13.2%	-1.6%
2001	-14.0%	-2.2%
2002	-16.4%	-5.8%
2003	-16.3%	-6.3%

* Step plan ended July 1, 1987

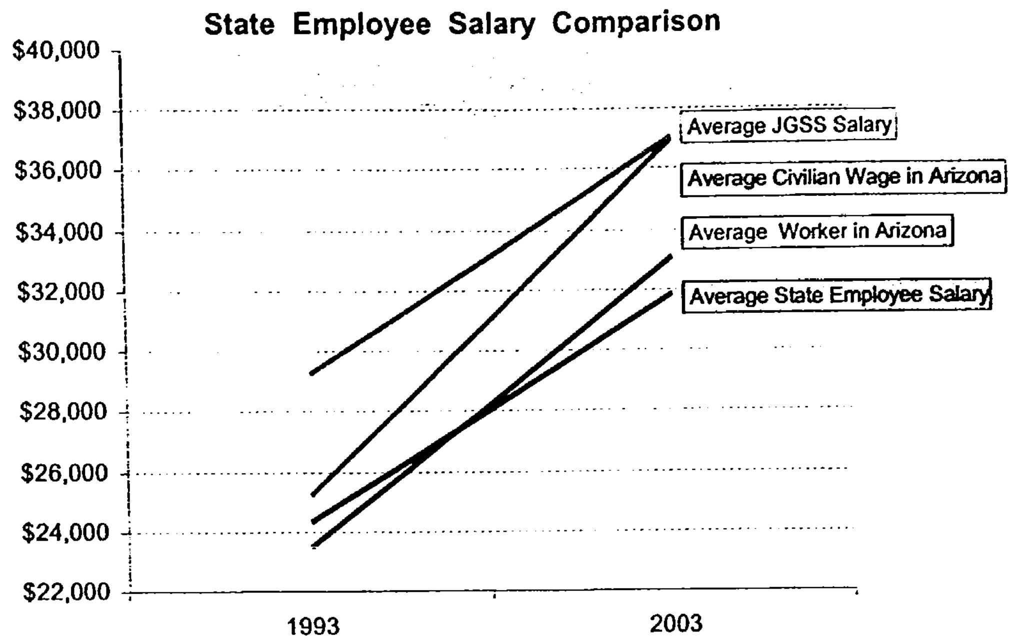
STATE OF ARIZONA vs ARIZONA MARKET WAGE INDICATIORS

As shown in Figure 2, *State Employee Salary Comparison*, the Average State Employee Salary trend line continues to fall below all other Arizona market wage indicators – JGSS, Eller College of Business, and the Bureau of Labor Statistics (BLS).[5]

Of the salary trend lines shown in this figure, the information from the JGSS provides the most equitable job comparison survey in terms of the types of jobs included. Both the Eller and BLS information include full- and part-time workers in seasonal and temporary jobs, in construction, manufacturing, retail, and (in the case of BLS), agriculture.

[5] JGSS figures include occupational groupings of clerical, food services, skilled/trades, unskilled, information management/communication, medical, professional, and miscellaneous (such as investigator, paralegal, interpreter, graphic artist, etc.) **Eller College of Business** figures include total Arizona non-agricultural workers. **BLS** figures include all types of employment for full- and part-time workers, including seasonal and temporary, in construction, manufacturing, retail, finance, transportation, government, and services in large Arizona cities. **HRMS** figures include covered, permanent full-time employees

Figure 2



Sources: Average JGSS Salary, March 2003
Average Civilian Wage in Arizona, Eller College of Business, March 2003
Average Worker in Arizona, BLS, December 2002, aged 1%
Average State Employee, HRMS, State of Arizona, June 2003

STATE OF ARIZONA TOTAL COMPENSATION vs OTHER STATE GOVERNMENTS

Total compensation is defined as the total value of an employee's direct and indirect compensation provided by the employer. The State's total compensation package is important on an individual basis and should be promoted to employees as a solid, competitive plan. Since the State spends a significant amount of money on benefits, employees should understand that it is an expenditure in their behalf, just like salary is an expenditure. Employees should realize the cost of benefits is far greater than just the employee portion.

According to the *2002 Central States Compensation Association* survey (which includes all Western states except California), Arizona is third from the bottom of the twenty-three state governments. The State of Arizona contributes an additional 33% of each employee's salary toward benefits, far less than the average 40%. The following chart, Figure 3, shows the specific comparisons from the survey:

Figure 3

State	Total Compensation	Average Salary	Benefits *	Benefit's Percent of Salary
Illinois	64,741	44,607	20,134	45%
Michigan	62,712	43,618	19,094	44%
Colorado	60,213	47,088	13,125	28%
Minnesota	58,115	43,493	14,622	34%
Iowa	57,763	41,289	16,474	40%
Wisconsin	54,927	39,618	15,309	39%
Oregon	52,382	38,508	13,874	36%
Nevada	51,948	37,554	14,394	38%
Idaho	49,238	34,075	15,163	44%
Wyoming	48,810	35,020	13,790	39%
Utah	48,183	35,433	12,750	36%
New Mexico	46,244	32,558	13,686	42%
Louisiana	44,220	30,014	14,206	47%
Arkansas	43,975	29,831	14,144	47%
Nebraska	43,627	32,000	11,627	36%
Oklahoma	43,039	29,935	13,104	44%
Montana	42,998	30,580	12,418	41%
Kansas	42,722	30,575	12,147	40%
North Dakota	42,671	32,292	10,379	32%
South Dakota	42,651	29,859	12,792	43%
Texas	42,562	31,039	11,523	37%
Arizona	**42,286**	**31,824**	**10,462**	**33%**
Indiana	41,054	28,553	12,501	44%
Missouri	40,284	27,950	12,334	44%
Average	**48,916**	**35,021**	**13,895**	**40%**

* Benefits include: health, dental, life, vision, sick hours, vacation, holidays, retirement, and Social Security

The State will be conducting further research in FY 2004 to assess the overall competitiveness of the State's employee benefits to those offered by other organizations located in Arizona.

NATIONAL MARKET TRENDS

In spite of the troubled economy, nationally organizations continue to budget for salary increases as shown in the chart below.

Source[6]	2003 Actual % Increase	2004 Projected % Increase
Mercer	3.6	3.6
WorldatWork	3.5	3.6
Conference Board	3.5	3.5
State of Arizona	*0*	*0*

According to these national survey sources, businesses are finding it difficult to balance salary budgets with the rising cost of benefit plans, particularly in a depressed economic climate that will not tolerate significant increases in product or service pricing. Unfortunately, the pressure is often released through layoffs, which in turn create a surplus of labor and reduced turnover. Employees with jobs are simply not inclined to seek other job opportunities, which works well for those employers that typically pay below market, as the State does.

Inflation is expected to average 2.6% for 2003 and 2.7% for 2004. In most cases, these percentages will net workers about 1% in increased pay. However, rising benefit costs are not necessarily factored into the equation because of the infinite ways benefit packages are configured and the variety of arrangements for sharing the expenses between employees and employers.

ARIZONA MARKET TRENDS

The information for the Arizona market trends shown in the chart below were obtained from the *Joint Governmental Salary Survey* conducted by ADOA each year. The survey is completed early in the year and projections for 2004 were made in March.

Arizona Comparison	2003 Actual % Increase	2004 Projected % Increase
Public (51)	4.1	3.7
Private (127)	4.0	3.9
Overall	4.0	3.9
State of Arizona	*0*	*0*

[6] **Mercer Human Resources Consulting, Inc.** - international human resources consulting firm recognized for its work in compensation and benefits; provider of salary surveys, studies, and trend analysis for the private and public sectors. **WorldatWork** - world wide nonprofit association dedicated to compensation, benefits, total rewards, and HR professionals. **Conference Board** - nonprofit organization that creates and disseminates information about management and the marketplace to help businesses assess the current economic picture and intelligently forecast trends.

The "Projected Increases" in the charts above do not reflect those organizations, that have "zero budgets" or salary freezes. Thus, the percentages only reflect those employers with salary increase budgets. If "zero budget" organizations were included, the percentages would likely be two to three tenths less than shown.

Of the 188 participants in the 2003 *Joint Governmental Salary Survey,* 15 (8%) have frozen their salary budgets, and an equal number have either postponed or canceled their general or merit increases for 2003.

Nationally, the percent of organizations surveyed by the Conference Board that are in a freeze status is 12%, which is down from 16% in 2002. The actual number may be much higher than reported, because some organizations do not participate in surveys when no money is budgeted.

CHANGES IN EMPLOYEES WAGES

In the April 2003 issue of *Arizona's Economy*, Alberta H. Charney writes, "While private sector employees enjoyed a 20% increase in real income from 1990 to 2001, State and local government employees suffered a 14.9 percent decline in purchasing power." [7]

This decline in purchasing power can be shown through a comparison of real examples of current employees' take home pay in 1998 *versus* what they took home in 2002. The numbers in this chart are directly from payroll records for three ADOA employees:

98/net	02/net	Variance	Job Title
$13,851	$13,908	$56	Admin Asst I
$16,526	$16,864	$338	Custodial Wrkr II
$21,813	$22,481	$668	Bldg Maint Tech II

In the first example, this employee receives **$2.15 more per check** than he or she did in 1998, even after several general increases in salary. Unfortunately, the upward movement in benefit premiums and retirement contributions, coupled with inflation, has offset the general salary increases. The 02/net figure shown above does not reflect the increase in retirement contributions that was effective July 1, 2003; the net earnings of State employees will decrease further as a result of the increased retirement contributions.

To further reinforce this point, interview results from employees leaving State service make it clear that they are critical of the State's compensation programs. For instance, the Department of Juvenile Corrections systematically conducts exit interviews with employees terminating "in good standing" in order to identify employee issues and detect negative trends. One question dealing with the reasons for leaving has "insufficient pay" as the second most frequent answer ("better job" being the first), and another question has "higher pay" as the most frequent response.

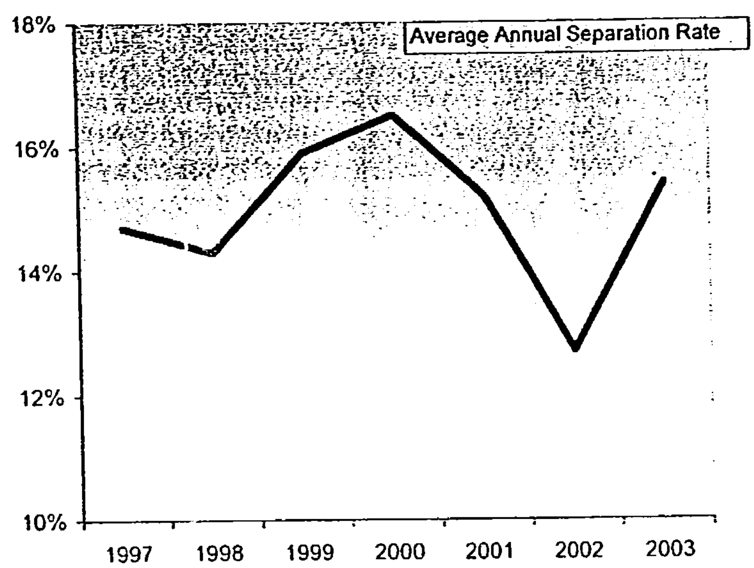
[7] "The Budget Crisis Was Predictable," Alberta H. Charney, Ph.D., *Arizona's Economy*, April 2003.

TURNOVER

Turnover limits the State's ability to provide superior customer service, disrupts programs and operations, and is very costly. The cost impact of turnover is both direct – in compensating departing employees for accrued leave and in recruiting and training replacements – and indirect, in increased workload demands, need for overtime, and in slower service delivery.

The State's turnover rate has returned to a rate typical of the years prior to 2002. The current rate for covered (merit system) employees is 15.4%, compared to 12.7% last year.

Figure 4
Separation Rates of Covered Employees



Source: HRMS June 2003; includes voluntary and involuntary separations

COMPENSATION OPTIONS

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- This program will be performance driven, not an incentive plan similar to "PIPP."

The cost of a performance fund can be relatively insignificant when compared to the total payroll, but for purposes of illustration a very simple formula is suggested. Starting with the premise that a 5% lump sum award is significant in the eyes of employees, and estimating that the State wants to target 10% of the employee population for an award, the funding for all agencies, state wide is $6 million.

OFFER NON-CASH COMPENSATION OPTION

With the understanding that no budget dollars exist for base salary increases, there are other alternatives that should be considered for recognizing State employees' contributions and their loyalty to State service. Following is one example of a high value, non-cash benefit.

Paid Holiday Added

Based on the average number of paid holidays for the twenty-five Western state governments, Arizona's ten paid holidays is one day short of the average. The common day missing from Arizona's schedule is the day after Thanksgiving; another option is a "floating" holiday, or personal business day. Many of the other states have local holidays not recognized across the nation, such as Texas Independence Day, Mardi Gras Day, LBJ's Birthday, or Pioneer Day.[8]

According to a survey of the State's human resources managers, time off is a very desirable non-cash commodity for the following reasons:

- Two income families have little time for family or personal obligations.
- Stress induced by hectic schedules leads to health problems that manifest in higher medical costs and absenteeism.
- Emotional stress due to guilt over not being available for family.

---

[8] 2002 Central States Compensation Association Survey

ADDRESS CRITICAL JOBS

It is clearly understood that funding for any broad based salary adjustments, such as general or merit increases, is essentially not available short term. But with the thought that limited compensation funding *may* become a reality at some point in the future, the most vulnerable and market sensitive job families have been identified in this section of this Recommendation. To be included in this section, the State's benchmark job must fall into one of two groups.

Group 1
The first group meets the following criteria:

- **Salary range midpoint** at least **20% below** the survey's average midpoint,
- **Employee average salaries** at least **20% below** the survey's actual average salaries,
- Represent a significant number of employees.

The broader job families identified and justified as "critical" are:

- Professional and Administrative
- Paraprofessionals and Clerical

The tool used to isolate the market critical classifications is the "Market Index." Briefly, the "Market Index" is a simple numerical calculation that combines the salary survey information on benchmark classifications, including average salary comparisons, midpoint comparisons, and the number of employees in the classification.

Standard salary survey practice matches one classification in a family of jobs, such as "Child Protective Services Specialist III." This benchmark classification is then used as the basis for adjusting the other classifications in the family, e.g., I, II, and supervisor. The broader grouping presented in this section may include multiple benchmark jobs.

The costing estimates for the recommendations are based on bringing the average salaries for State employees to 10% below the market average salaries for the job family.

Professional and Administrative

This category encompasses more than 15,000 employees. Within the category, classifications that meet the criteria above include such classifications as Child Protective Services Specialists and Supervisors, Human Service Specialists, Social Service Administrators, and Environmental Program Specialists. Approximately 2,600 employees populate these classes, which have salaries that fall 29% to 33% below market.

Ideally, funding would be approved to bring these classifications to within 10% of the market midpoint according to the detailed survey results and salary survey analysis completed by compensation staff. The first year expense for bringing the average salary of employees in these classifications to within 10% of the respective market rates would be approximately $15,000,000. A lower funding amount could be used to prioritize the classifications based on highest vulnerability to turnover, focusing on those with greater risk to State services if significant vacancies occurred, e.g., Child Protective Services.

Paraprofessionals and Clerical

These broad job families represent over 8,700 employees, or approximately 25% of all State workers. Classifications in this group include Executive Staff Assistants, Administrative Assistants, Legal Assistants, Human Service Workers, Secretaries, Administrative Support Supervisors, and Clerk Typists. State salaries for these classes are 30% or more below market.

The backbone of the State's workforce is represented here because of their support role in almost every agency. Because many are at or near the entry level classifications in State service, they are the most susceptible to excessive turnover, high training expenses, and are very difficult to recruit for when pay is low and locations are not convenient.

Ideally, funding would be approved to bring these classifications to within 10% of the market midpoint according to the detailed survey results and salary survey analysis completed by compensation staff. The first year expense for bringing the average salary of employees in these classifications to within 10% of the respective market rates would be approximately $867,000. A lower funding amount could be used to prioritize the classifications based on highest vulnerability to turnover, focusing on those with greater risk to State services if significant vacancies occurred, e.g., Administrative Assistants.

Group 2

The State's benchmark must meet the following criteria to fall into the second group:

- **Turnover** identified as a significant problem for the agencies utilizing the positions.
- **Market factors** indicate a pending recruitment/retention issue.
- Identified as **Critical Services** offered by the State.

The broader job families identified and justified as "critical" are:

- Protective Services
- Nursing Professionals

Protective Services

These classifications, in the ADOA payroll system, include Correctional Officers and Youth Correctional Officers, and represent approximately 7,300 employees. Turnover for Youth Correctional Officers was 48.7% last year. Average salaries by classification are 23% to 40% below the local market.

Protective service positions are critical to the mission of State government and fulfill one of the highest needs for its citizens. In order to attract and retain employees with these skills, the State has to compete with other governmental agencies having similar staffing needs, e.g., the police departments, sheriff offices, and probation functions.

Currently, Correctional Officers, both adult and youth, utilize special pay plans. An extensive study of these plans, paired with analysis of the market situation, will result in a determination of the functionality of these "step" plans. This determination will lead to a recommendation for the future salary plans for these classifications.

Nursing Professionals

All registered nurses and related nursing classes are included in this general group. Currently, State nursing salaries are close enough to market levels to be considered competitive IF base salaries plus stipends and other special pay are included. However, vacancy rates remain very high, and vacancy savings have been utilized to fund the stipends for many agencies.

Other factors adding to the criticality of this group include:

- The limited supply of nurses in Arizona, which makes it a very competitive market;
- Planned new beds in the Phoenix metro area
    - 74-bed acute care facility at West Valley Hospital Medical Center opening September 2003
    - Banner Health Systems plans for 120 beds in East Phoenix this year
    - New Maricopa County Jail in South Phoenix, with 2300 inmates requiring 60 nurses
    - Banner Estrella Medical Center opening November 2004.
- Turnover rates above 30% for nursing professionals.

The Department of Administration plans to complete an extensive study of nursing positions in Arizona, to include salaries, benefits, incentives, perquisites, and staffing forecasts. Upon completion of this study, ADOA plans to design and recommend an inclusive, total compensation plan for the nursing professionals.

Attachment 1

VARIANCE COMPARISON 2003
JGSS SALARY SURVEY RESULTS

The variances displayed below reflect a comparison of State Service pay practices to the labor market throughout Arizona for six (6) occupational groupings. The data utilized is obtained from the Joint Governmental Salary and Benefits Survey (JGSS) Survey. The negative variances in red reflect how much the market exceeds State salaries; positive variances in green indicate that state salaries exceed what the market is paying. Variance is calculated using weighting by number of state employees in the benchmarks.

STATE SERVICE VS JGSS VARIANCE *

Occupational Group	St Actual Mn to Mkt Avg Mn	Midpoint to Mkt Average	St Actual Mx to Mkt Avg Mx	St Avg to Mkt Avg
Technical 2003	-35.0%	-19.1%	+10.5%	-27.7%
Prof/Admin 2003	-36.6%	-12.0%	+0.5%	-22.8%
Clerical 2003	25.9%	-6.9%	-0.9%	-20.8%
Trades 2003	-16.6%	-5.6%	+5.6%	-15.4%
Medical 2003	-3.5%	-10.9%	+3.8%	-2.5%
Service/Maint 2003	-7.3%	+9.3%	+9.6%	-1.6%
Overall Variance 2003	-27.4%	-9.0%	+1.6%	-19.0%

STATE SERVICE VS WESTERN STATES VARIANCE *

	St Actual Mn to Mkt Avg Mn	Midpoint to Mkt Average	St Actual Mx to Mkt Avg Mx	St Avg to Mkt Avg
Western States 2003 (Excludes Director, Asst. Director Benchmarks)	-20.4%	-8.5%	-1.1%	-21.3%

STATE SERVICE VS COMBINED WESTERN STATES/JGSS VARIANCE *

Western & JGSS Combined 2003	-22.2%	-8.6%	-0.4%	-20.7%

* "Actual Minimum" refers to the Hiring Rate or Lowest Salary Paid; "Actual Maximum" refers to the Highest Salary Paid.

ATTACHMENT C

ATTACHMENT D

2003 Total Compensation Study

Presentation to
Joint Legislative Study Committee on State Employee Compensation

Elliot R. Susseles

December 3, 2003

SEGAL

1230 W. Washington St.
Suite 501
Tempe, AZ 85281-1248

Outline

- Purpose and Goals of the Study
- Study Methodology
- Study Results
- Conclusions and Recommendations
- Questions and Answers

3 December, 2003

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Purpose and Goals of the Study

- Assess the State's position in the market place with regard to total compensation (salary, paid time off, and benefits).
- Enhance the Arizona Department of Administration's Advisory Recommendations to the Governor and the Legislature for adjustments to the Personnel System Salary Plan.
- Respond to Legislative requests for information regarding specific bills that have been introduced during session.
- Provide senior management with the tools to give factual responses to salary and benefits concerns or issues as they arise.

3 December, 2003

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1

Study Methodology

➢Collect data on the following aspects of total compensation:

- Current base salary;
- Paid leave policies (annual and sick leave and holidays);
- Employer costs for insurance programs (health, vision, prescription drug, dental, life, and disability); and
- Required employer contributions to retirement programs (defined benefit plans, defined contribution plans, and Social Security contributions).

The study provides a comprehensive assessment of the State's costs to provide compensation and benefits to its workforce.

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3 December, 2003

2

Study Methodology *(continued)*

➢Compare the State's total compensation package to:

- Comparable State governments
  - Colorado, Nevada, New Mexico and Utah
- Local governments
  - Maricopa County, Pima County, City of Phoenix, and City of Tucson
- Large private sector employers in Arizona and the South Central States

+1,000 employees

The three employer segments represent the vast majority of organizations considered by the State as its labor markets.

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3 December, 2003

3

D

Study Methodology *(continued)*

➢ **Data Sources Used:**

Market Sector	Direct Compensation Data Sources (Salary)	Indirect Compensation Data Sources (other benefits)
State Governments	Joint Government Salary Survey 2003 Western States Governmental Salary Survey 2003	State government web sites and direct contact with the human resources staff of each State
Local Governments	Joint Government Salary Survey 2003	Local government web sites and direct contact with the human resources staff of each jurisdiction
Private Sector	Joint Government Salary Survey 2003 (large employers with at least 1,000 employees) Watson Wyatt Geographic Report on Compensation 2002 (South Central States)	10 large, private sector clients of The Segal Company located throughout Arizona Watson Wyatt Survey Report on Employee Benefits 2003/2004

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Study Methodology *(continued)*

- To determine the <u>direct compensation</u> (salary) for each market comparator, we calculated:
  - The actual average base salaries of the 51 benchmark job titles; and
  - The value of paid time off in a year, assuming an employee with 7 years of service (the number of accrued days x the daily pay rate).
- We subtracted the value of paid time off from the average salary amount to arrive at the "average salary for days worked".
- For example, in Colorado, the average salary for employees in the 51 jobs is $50,391 (or $193.81 per day). The number of accrued days off for a person with 7 years of service is 35 (15 vacation days, 10 sick days, 10 holidays). Therefore the value of 35 days is $6,783.40.

$50,391 (total base salary) - $6,783.40 (value of paid days off) = $43,607.60.

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Study Methodology *(continued)*

- To determine the indirect compensation (benefits) for each market comparator, we calculated:
  - The average employer contribution rate for each type (HMO, PPO, etc.) and coverage level (single, family) of *health insurance plan*; and
  - The average employer contribution for each type (PPO, prepaid) and coverage level (single, family) of *dental insurance plan.*
- We then determined the "blended rate" for all plan types and coverage levels by applying the State's enrollment distribution to the employer's contribution rates.

3 December, 2003

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6

Study Methodology *(continued)*

- We calculated the annual employer cost of *life insurance* by multiplying the monthly rate by 12. If an employer's insurance benefit is based on salary, we determined the cost by applying the rate per $1,000 of benefit to the actual average base salary.
- For *retirement benefits*, we determined the required employer contribution rates in the current plan year for the following:
  - Defined benefit plans;
  - Defined contribution or deferred compensation plans; and
  - Social Security.
- The contribution rates were then multiplied by the actual average base salary to determine the average contribution costs.

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7

Study Results

- The State's total compensation package is not competitive.
- An increase of at least 23 percent is required to equal the market average in all three market segments as of 2003.

	State Governments	Local Governments	Private Sector	Market Average	State of Arizona	Market Average Index
Actual Average Salary for Days Worked	$35,628	$35,724	$37,148	$36,167	$28,599	79%
Value of Paid Time Off	$6,157	$6,516	$6,300	$6,324	$5,200	82%
Medical and Dental Insurance Cost	$5,162	$5,818	$5,046	$5,342	$6,160	115%
Life Insurance	$67	$67	$127	$87	$38	44%
Retirement Benefits*	$6,883	$6,826	$5,496	$6,402	$3,971	62%
Total Compensation Costs	**$53,897**	**$54,951**	**$54,116**	**$54,322**	**$43,968**	**81%**
Increase Required for the State of Arizona to Equal the Market Average	**23%**	**25%**	**23%**	**24%**	–	–

* Retirement benefit costs include contributions to Social Security, except for the States of Colorado and Nevada which do not participate in Social Security.

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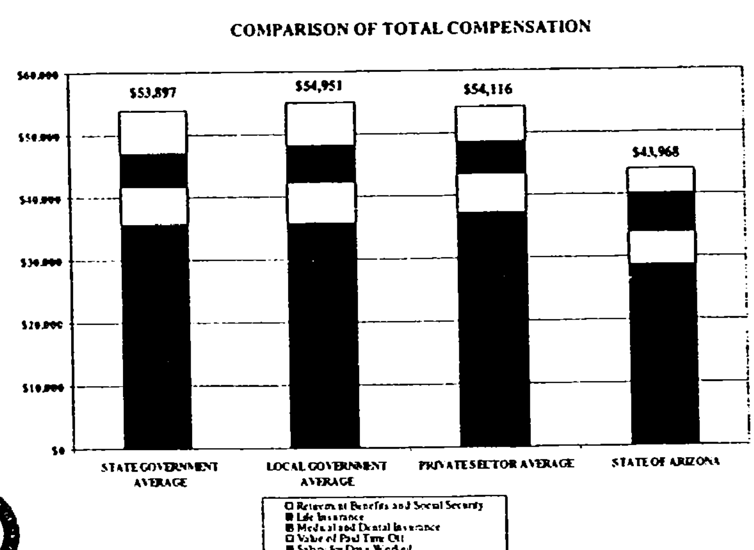
Study Results *(continued)*



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3 December, 2003

Salary (Direct Compensation) Analysis

➢51 job titles (representing 14,538 State employees) were analyzed.

	State Governments	Local Governments	Private Sector	State of Arizona
Salary for Time Worked	$35,628	$35,724	$37,148	$28,599
Value of Paid Time Off	$6,157	$6,516	$6,300	$5,200
Actual Average Salaries	**$41,785**	**$42,240**	**$43,448**	**$33,799**
Adjustment Needed to Equal Market Average	**24%**	**25%**	**29%**	--

To equal market rates, the State would need to increase salaries by 24% to 29%.

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10

Benefits (Indirect Compensation) Analysis

Indirect Compensation	State Governments	Local Governments	Private Sector	State of Arizona
Health Care Costs	$5,162	$5,818	$5,046	$6,160
Life Insurance	$67	$67	$127	$38
Retirement Benefits	$6,883	$6,826	$5,496	$3,971
Total Indirect Costs	**$12,112**	**$12,711**	**$10,668**	**$10,169**
Adjustment Needed to Equal Market Average	**19%**	**25%**	**5%**	--

Benefit plan design, claims experience, plan administration, and size and composition of the employee population are variances affecting cost that are not addressed by this study.

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11

Conclusions

- The State's total compensation package is not market competitive.
- This finding is consistent with prior studies conducted by ADOA.
- The gap is widening (i.e. State employees are being compensated more and more below market as time goes on).
- Assuming the comparators' pay rates increase by an average of two percent per year, in five years the State's pay gap would increase to approximately 36 percent.

3 December, 2003

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12

Recommendations

The State should consider several options to ensure that employees are compensated competitively:

- Improve annual pay increase budgets to catch up to market rates;
- Provide an additional paid day off, perhaps in the form of a floating holiday;
- Increase the State's contribution to the retirement benefit; and
- Increase the amount of State-paid employee life insurance.

Each option requires further analysis, taking into account economic impact and employee preferences.

3 December, 2003

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13

Total Compensation Study
for State of Arizona Employees

Questions?

SEGAL

3 December, 2003 Doc 147140

14

ATTACHMENT E

ADOA
Arizona Department of Administration

MERCER
Human Resource Consulting

THE SAGUARO PROGRAM
FOR YOUR BENEFIT

Self-insurance

Maximizing the value of health benefits for State employees and retirees through improved provider choice and program design.

Arizona Department of Administration
Mercer Human Resource Consulting

PROGRAM

CIGNA Renewal Percentages

Initial contract signing with CIGNA for first year: $290 million

- First Renewal:
  - Requested: 30% increase
  - Negotiated: 19% increase
  - Total Paid: $350 million

- Second Renewal:
  - Requested: 23% increase
  - Implemented: 13% increase
  - Total Paid: $402 million

CIGNA received $36 million for administrative costs and $37 million in profit and risk charges in FY '03.

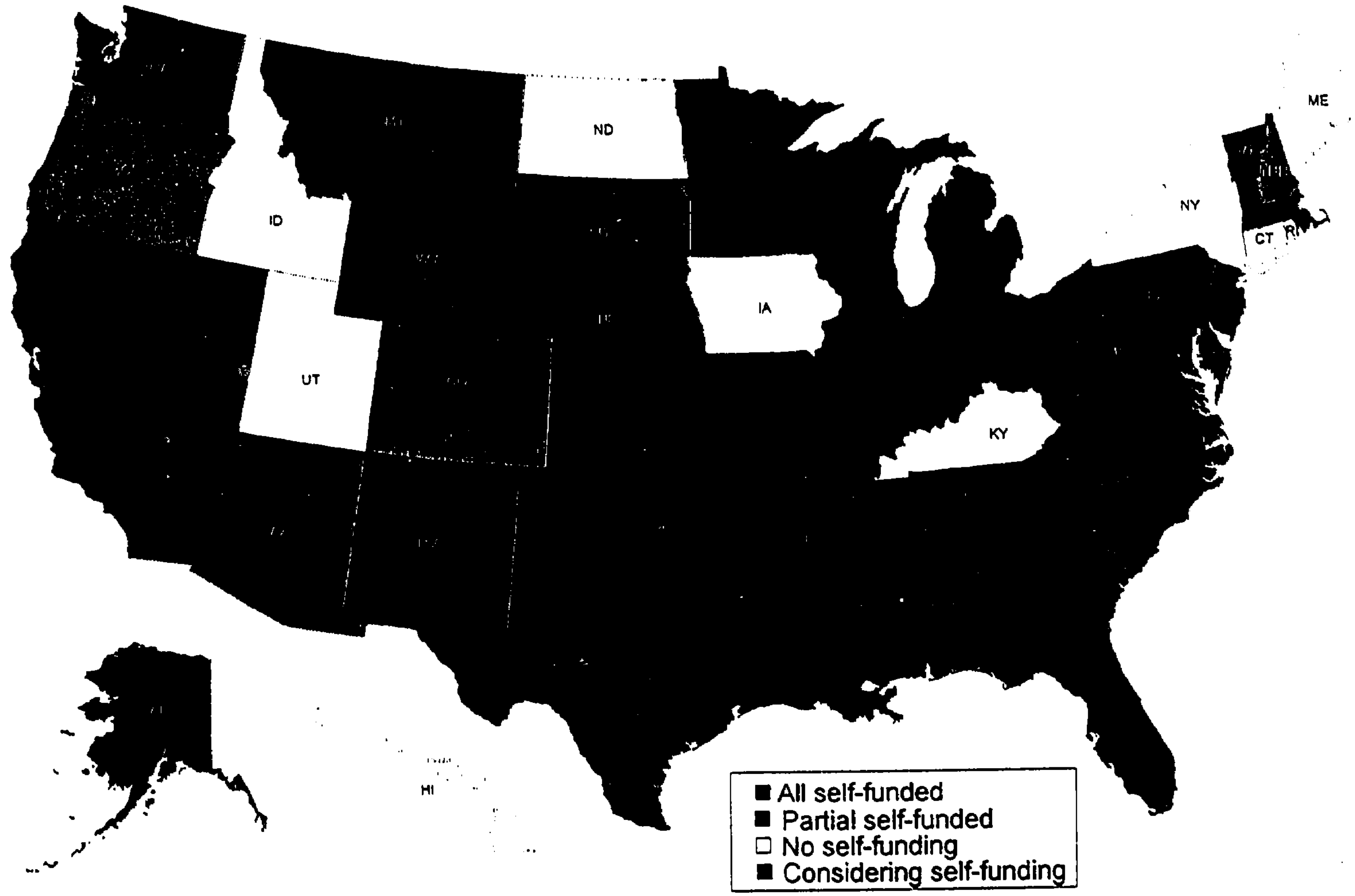
TOTAL CONTRACT INCREASE FROM INITIAL YEAR TO CURRENT YEAR — $112 Million

PROGRAM

FOR YOUR BENEFIT

What Oth r States Do

Self-funding of State Employee Health Plans



3

PROGRAM

ADOA Exp rience/Expertise in Self-Insurance

Risk Management

- Property and Liability: **Self-insured since 1976**
  - FY '03 — 8,551 claims for a paid total of $33.6 million

- Workers Compensation: **Self-insured since 1994**
  - FY '03 — 4,638 claims for a paid total of $17.9 million

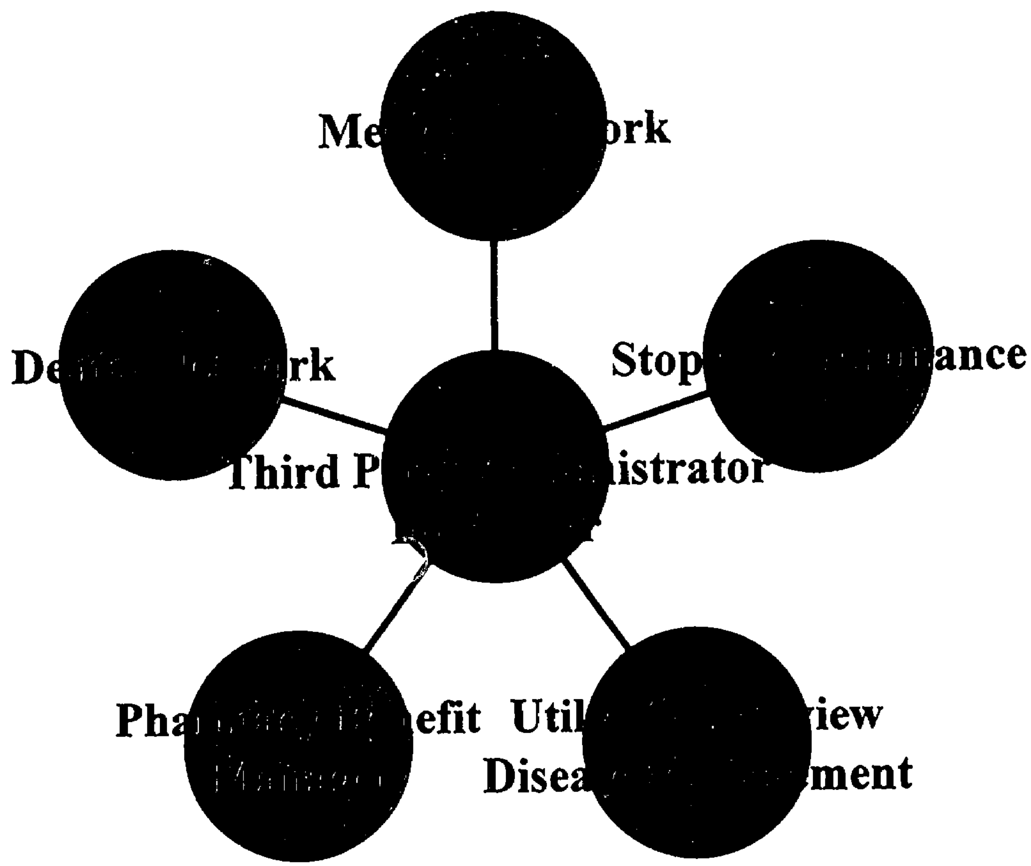
PROGRAM

Goals of Self-Insuring

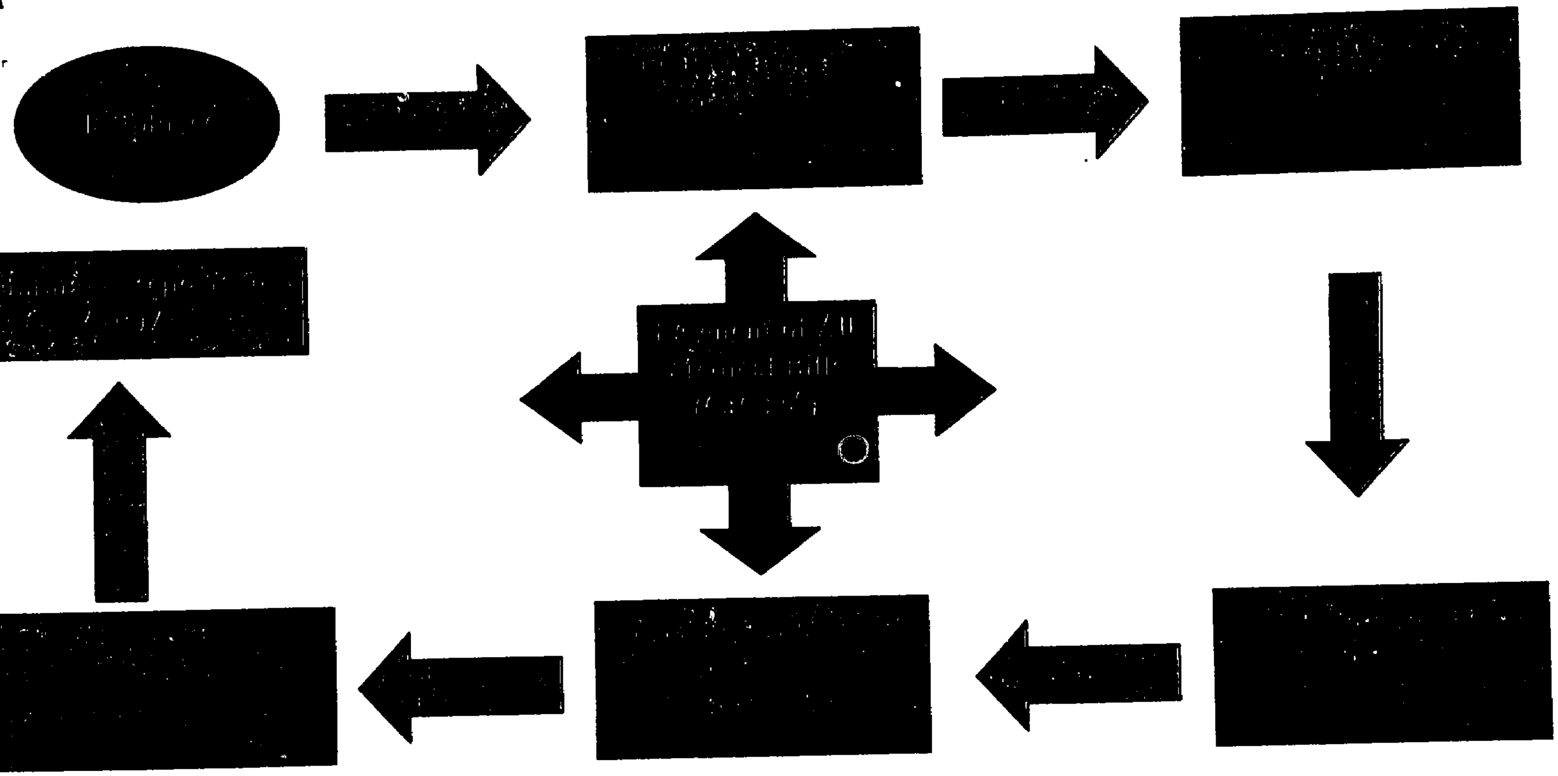
Maximize value of health benefits to State employees through improved choice and improved program design

- Employees: *Improved CHOICE*
  - Increased Choice in Providers
  - Improved Choice in Plan Design
- State: *Improved PROGRAM DESIGN*
  - Better understanding of treatment patterns to develop customized program
  - Increased flexibility over program decisions

Program Structur : Integrated Services

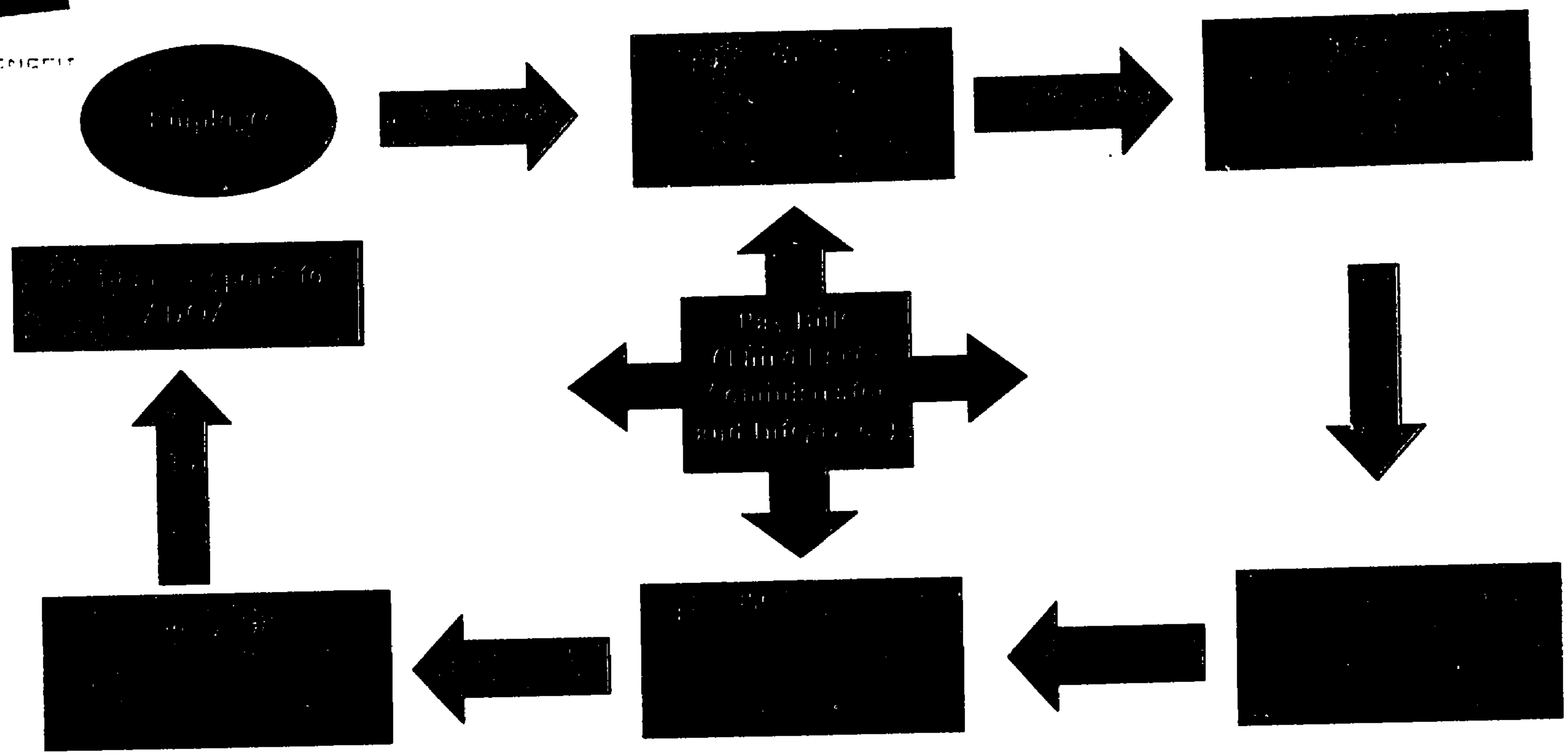


How Employees Access Medical Care with CIGNA



PROGRAM

How Empl y s Access Medical Care with Self-Insurance



Goals of Self-Insuring: Reality

Goals	Reality
Improved Choice	▪ Network - 7 Offerors ▪ Contracting - Anticipate: 2 EPO's/1-2 PPO's Urban Areas 1-2 EPO's/1 PPO Rural Areas ▪ Best Network by Service Area

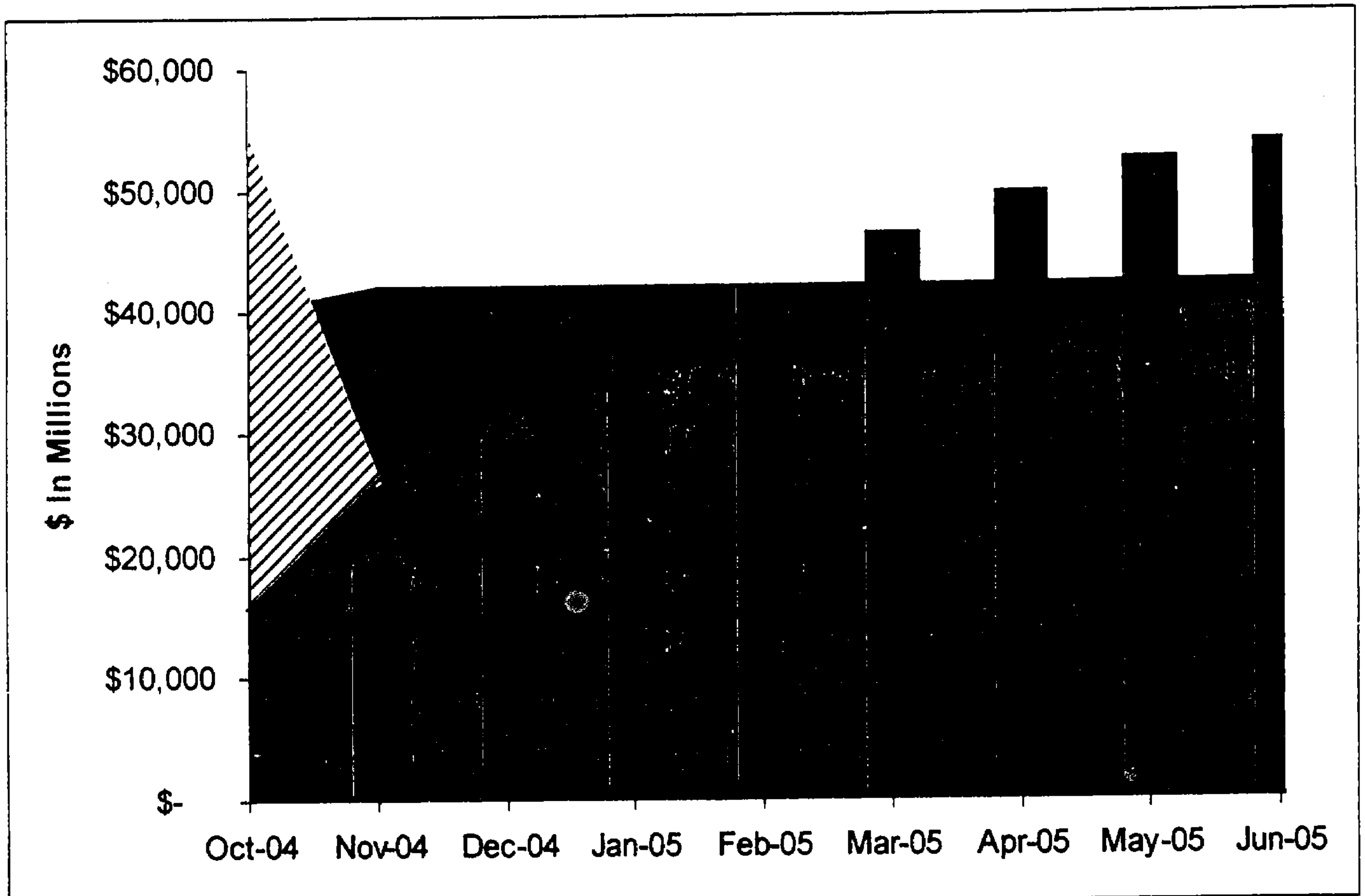
More Docs/Hospitals = More Choice and Better Access

Goals	Reality
Improved Program Design	▪ Offerors proposed new, innovative disease management programs customized to State Employees ▪ Offerors guaranteed admin fees and credits/assistance for up to 3 years ▪ Offerors are Best in Class in their Industry

Innovative/Best in Class Vendors = Better Program Design

PROGRAM

Reserve Accrual in the Fund



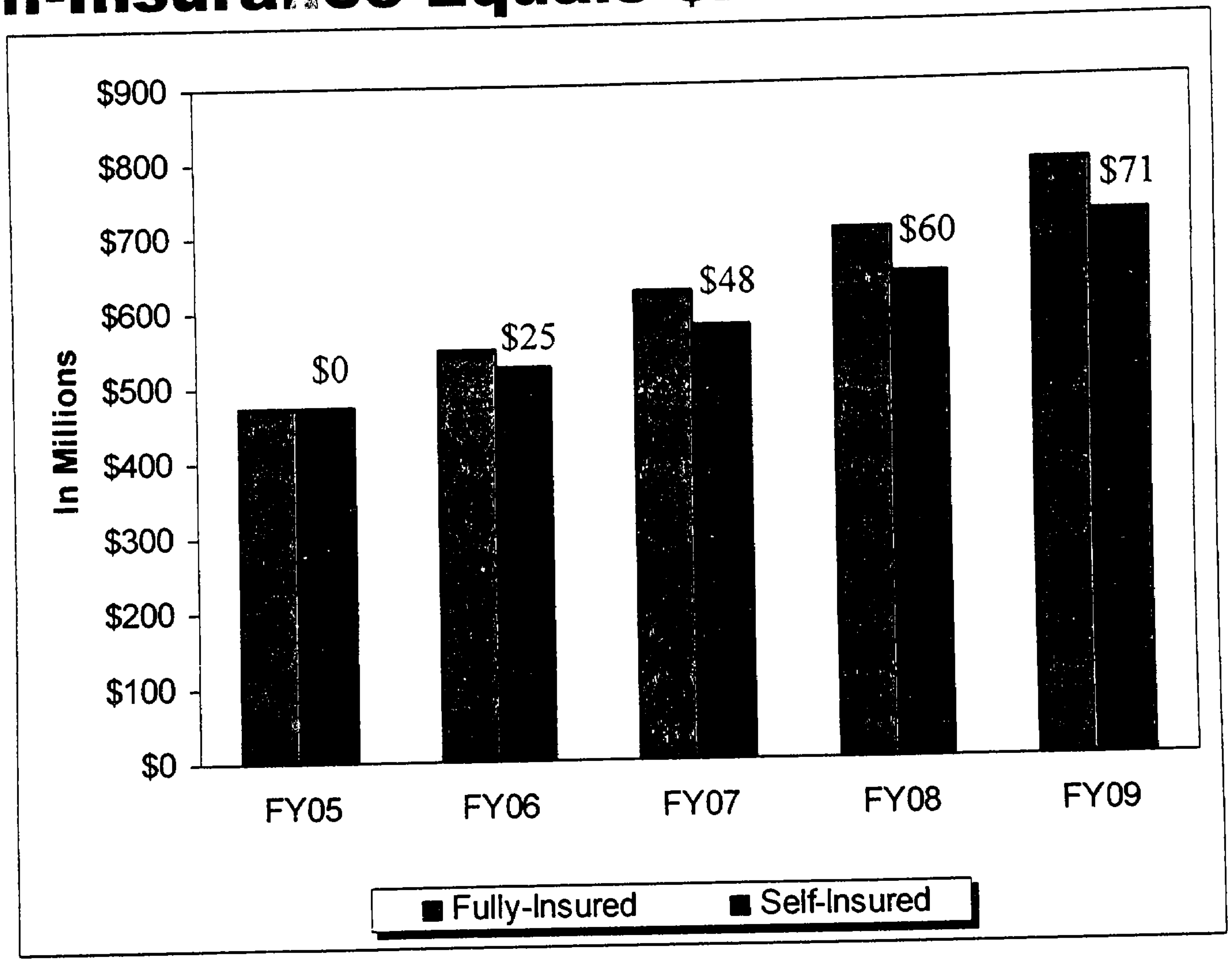
	Oct-04	Nov-04	Dec-04	Jan-05	Feb-05	Mar-05	Apr-05	May-05	Jun-05
Beginning Balance	$ 17,047	$ 4,186	$ 19,278	$ 29,364	$ 36,650	$ 41,799	$ 46,223	$ 49,543	$ 52,109
Plus Estimated Monthly Receipts	$ 40,047	$ 42,013	$ 42,013	$ 42,013	$ 42,013	$ 42,013	$ 42,013	$ 42,013	$ 42,013
Minus Estimated Total Expenditures	$ 52,908	$ 26,921	$ 31,927	$ 34,726	$ 36,864	$ 37,588	$ 38,693	$ 39,446	$ 40,590
Equals Estimated Claim Reserve Level	$ 4,186	$ 19,278	$ 29,364	$ 36,650	$ 41,799	$ 46,223	$ 49,543	$ 52,109	$ 53,531

Indicates October 2004 monthly total expenditures includes a lagging CIGNA premium payment of $37.8 million.

* Reserve calculations include medical and dental.

PROGRAM

Estimated 5-Year Savings with Self-Insurance Equals $204 Million



*Values represent savings per year in millions, totaling $204 million over 5 years.

** Values compare CIGNA administration at approximately 19% versus ADOA administration at approximately 14%

Shattering the Myths Related to Self-Insuranc

- **The State will need to come up with $80 million <u>immediately</u> for a claims reserve.**
  - **FALSE.** The claims reserve will be built up over time within the Health Insurance Trust Fund. It is estimated the Fund will accrue approximately $55 million by the end of FY '05 and an additional $25 million in FY '06. To ensure financial stability, Stop Loss Insurance will also be purchased to pay large claims over $250,000.
- **No large insurance companies proposed on the program.**
  - **FALSE.**
- **There was a poor response from potential contractors.**
  - **FALSE.** The State received multiple proposals from companies that specialize in self-insured programs. In total, the State received over 20 proposals for services from companies that cover hundreds of thousands of lives in Arizona.
- **State employees will be merged into the AHCCCS program.**
  - **FALSE.**

PROGRAM

Shattering th Myths R lated to Self-Insurance

- **The State should not take on this financial risk during a budget crisis.**
  - **FALSE.** Thirty-six (36) other states already self-insure all or a portion of their employee program. Most have been self-insured for over 15 years.
  - Nationally, between 1998 and 2002, healthcare premiums rose, on average, 61.3% for fully insured plans versus 42.5% for self-insured programs*. The move to self-insurance will allow the State to reduce rising healthcare premiums for State employees and retirees.
  - Most employers with over 5,000 employees are self-insured because it makes good business sense.

*Kaiser Family Foundation Study- 2002

ATTACHMENT F

Arizona Registrar of Contractors

Performance Incentive Program

Prepared for:

Joint Legislative Study Committee on State Employee Compensation

Israel G. Torres

Director

December 3, 2003

ROC Performance Incentive Pay Program

Began in 1995 with (2) Pilot Programs

- Call Center
- Inspections Department

Expansion to an Agency-wide PIPP program in 1996

Program Goals

Identify and Address Process improvement

Build Communication

Build Employee teamwork and cohesion

D

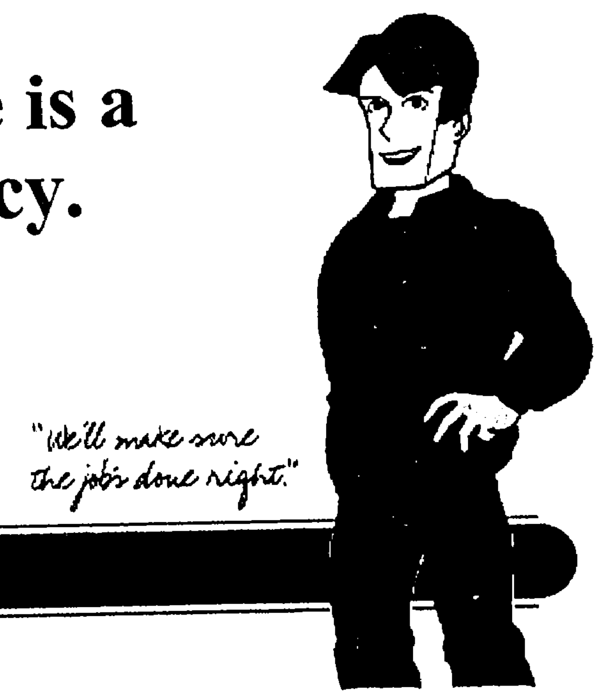
Guiding Principles

Provide Excellent Customer Service

Interaction with our customers is critical to the success of the ROC.

Maximize Productivity

How employees manage their time is a direct reflection of agency efficiency.



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Employee Committee

Comprised of ROC Employees

Meets Quarterly

- Employees Represent Departments

- Internal Audit Teams

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PROGRAM FORMULA

PRODUCTIVITY GOAL	**(25%)**
CUSTOMER SATISFACTION	**(25%)**
OVERALL AGENCY SCORE	**(50%)**
TOTAL SCORE	**(100%)**

Productivity Goals are tied to agency Strategic Plan

"We'll make sure the job's done right."

Customer Service Ratings

Internal Surveys

External Surveys

Internal Survey Card

ROC Administrative Services Division

These departments provide support services to you.
Please **rate and comment** on the services you receive from them.

	Excellent	Average	Poor
Accounting/Purchasing (Payroll, travel, equipment etc.)	☐	☐	☐
Information Technology (Computer support, reports etc.)	☐	☐	☐
Human Resources/Budget (Assist with benefits, staffing, budget etc.)	☐	☐	☐
Print Shop/Mail Room (Supplies, mail, printing needs etc.)	☐	☐	☐
Call Center (Call screening, message relay etc.)	☐	☐	☐

Comments: ____________________

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"We'll make sure the job's done right."

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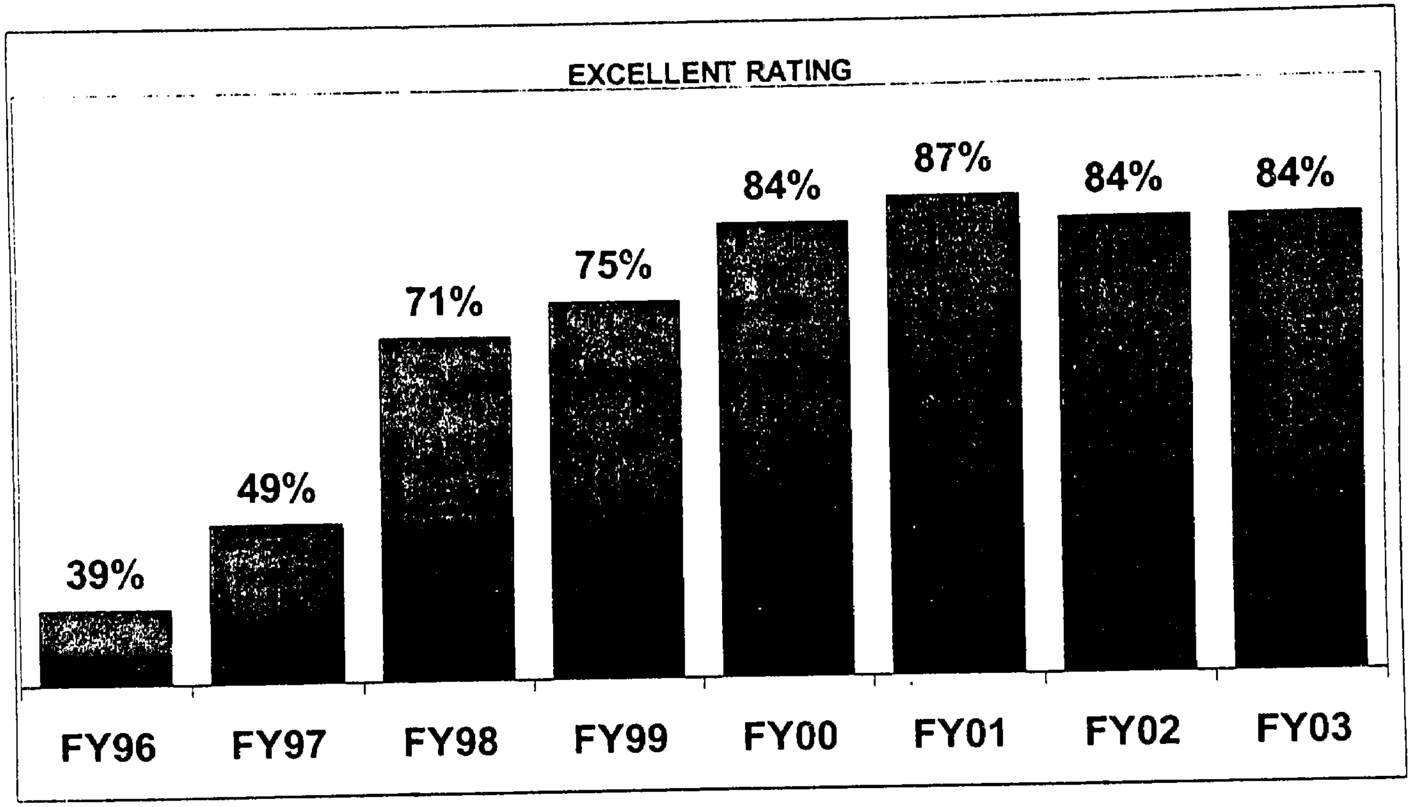
Internal Customers Ratings



"We'll make sure the job's done right."

External Survey Card

Registrar of Contractors

We are committed to providing the most timely, consistent and fair service possible.

You are the best one to tell us how we are doing. Please **rate** and **comment** on the service you have received. Fill out this **postage-paid** card and drop it in the mail today. Thank you very much.

Please check one and comment.

☐ **Excellent** ☐ **Average** ☐ **Poor**

____

____

____

____

Name and Phone (Optional) ________________________

"We'll make sure the job's done right."

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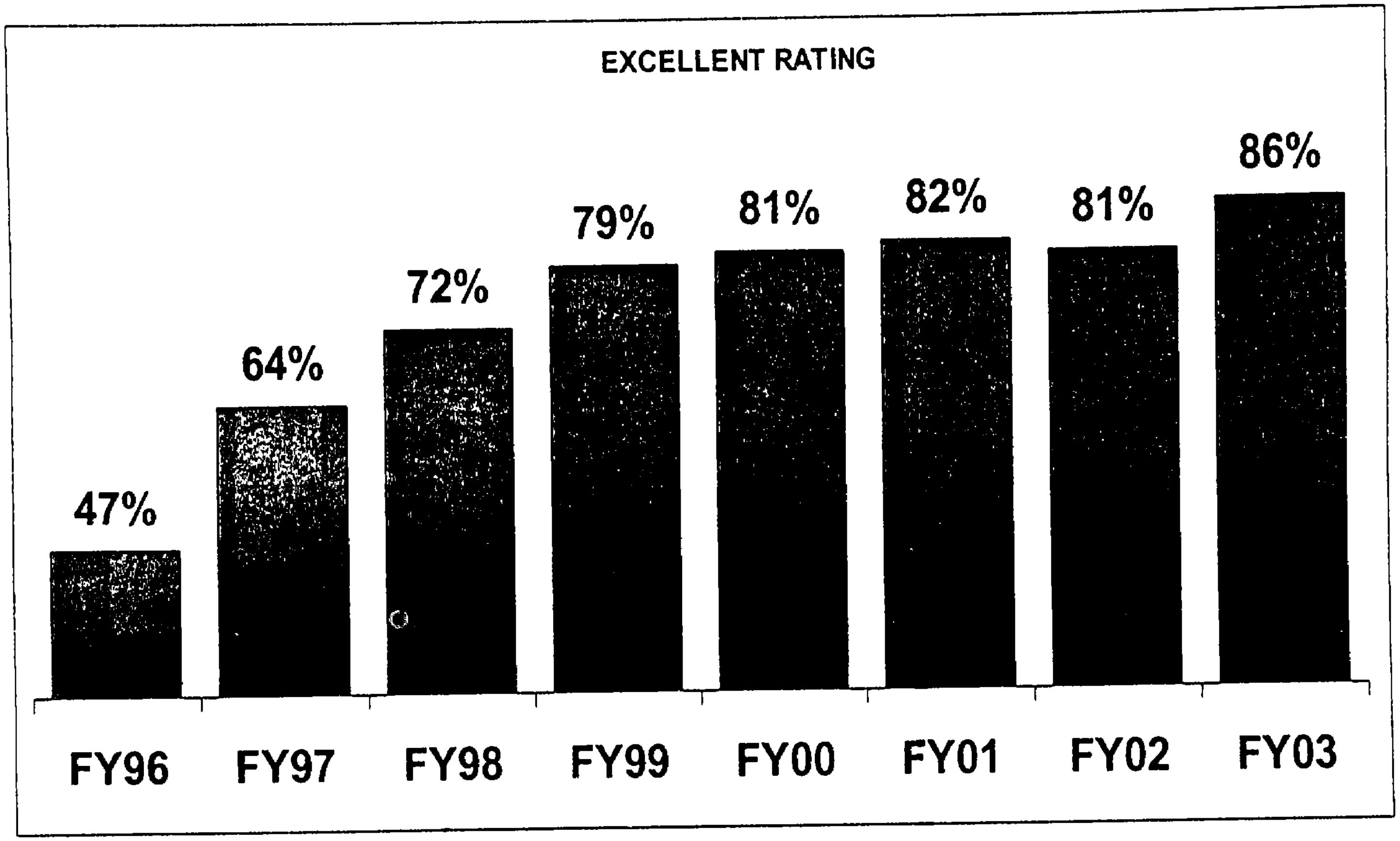
External Customers Ratings



"We'll make sure the job's done right."

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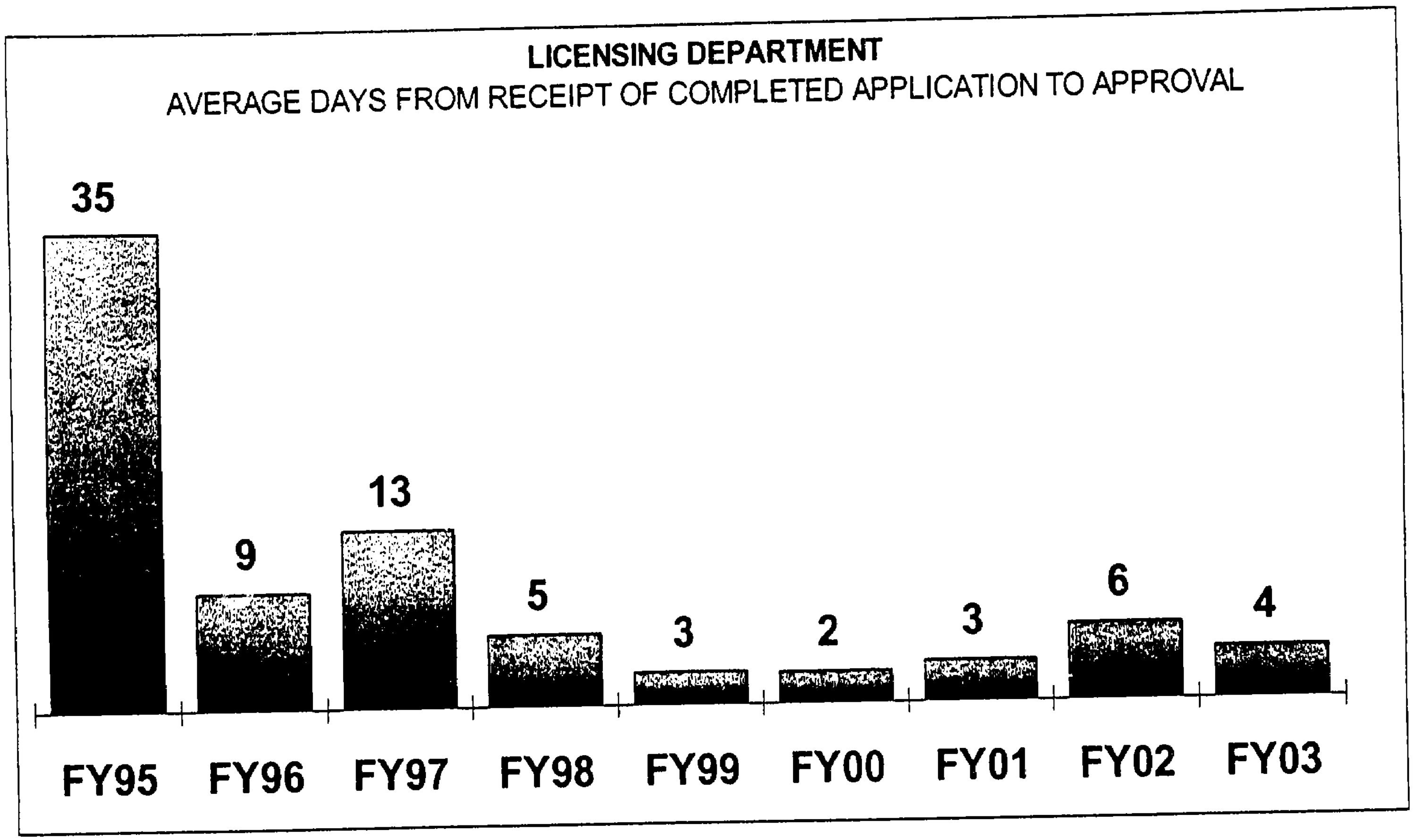
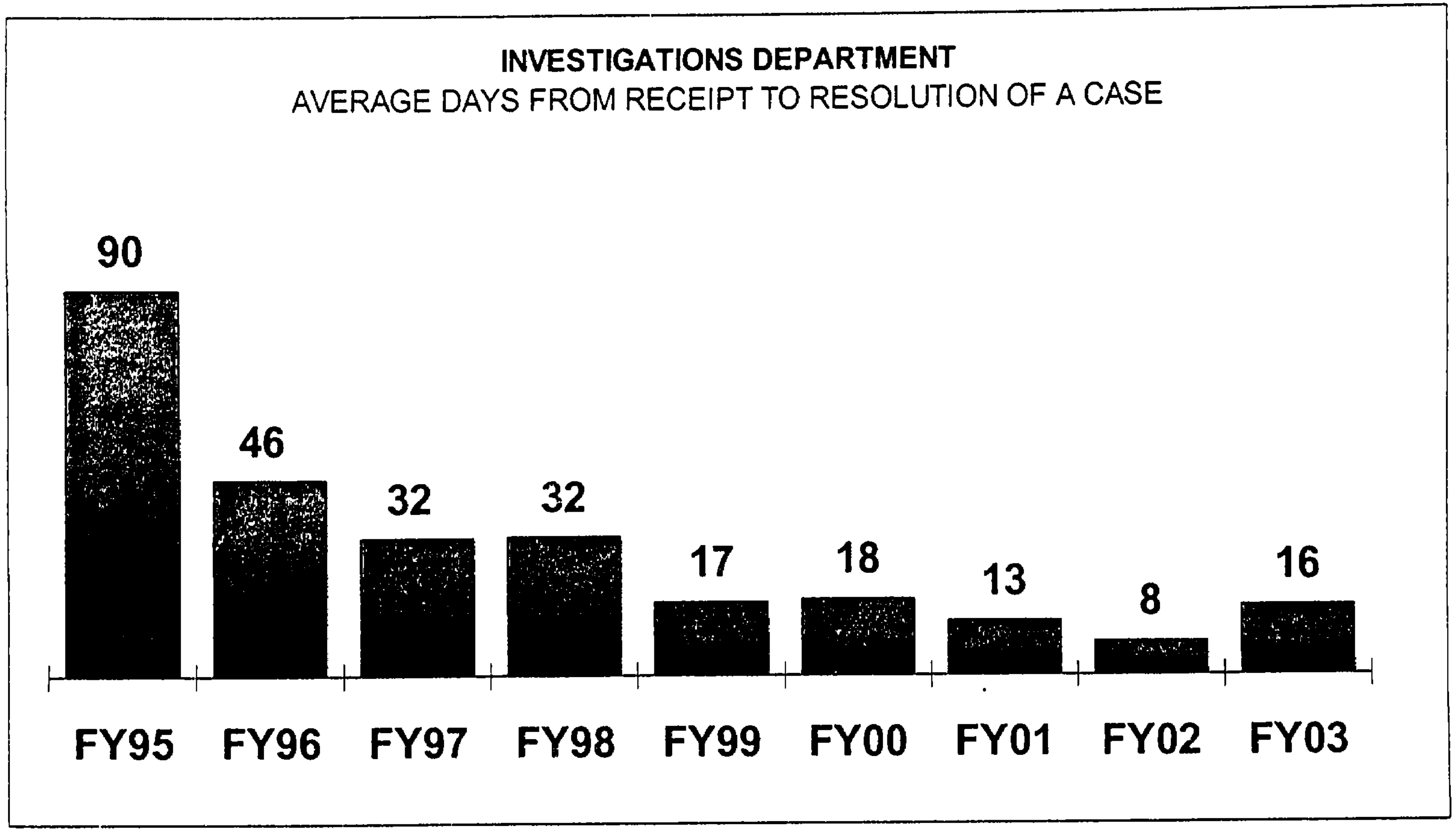
Success Stories

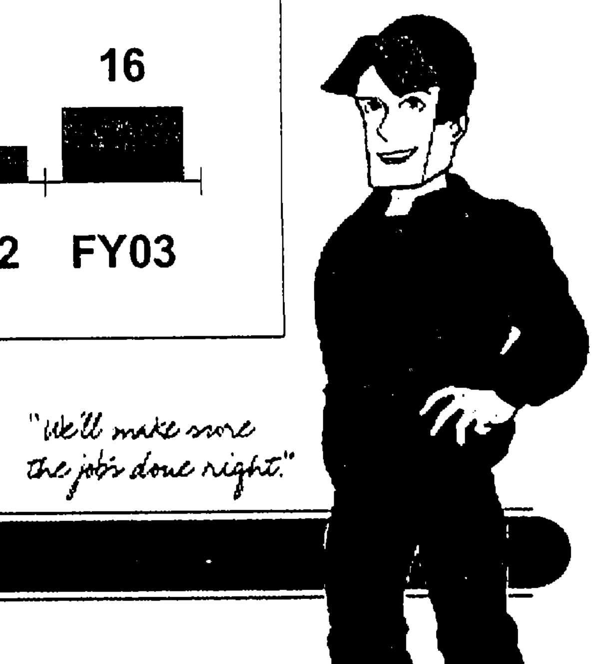


"We'll make sure the job's done right."

Arizona Registrar of Contractors • 1931 •

Success Stories





Arizona Registrar of Contractors • 1931 •

Questions?

Arizona Registrar of Contractors
• 1931 •

Arizona Registrar of Contractors
• 1931 •

ATTACHMENT G

Research

ARIZONA STATE LEGISLATURE

JOINT LEGISLATIVE STUDY COMMITTEE ON STATE EMPLOYEE COMPENSATION

Minutes of Meeting
Wednesday, September 10, 2003
10 a.m., Senate Hearing Room 109

Members Present:

Senator Tibshraeny, Cochair
Senator Leff
Senator Arzberger
Betsey Bayless
Bill Bell
Cathy McGonigle
Kathy Peckardt
Pam Tenney
Representative Huppenthal, Cochair
Representative McClure
Representative Burton Cahill
Alan Maguire
Leigh Cheatham
Shawn Nau
Linda Strock
Carl Williams

Staff:
Nadine Sapien, Senate Research Government Analyst
Michael Huckins, House of Representatives Government and Retirement Analyst

Chairman Tibshraeny called the meeting to order at 10:05 a.m., attendance was noted, and introductions of the Committee took place. He announced that another meeting would be held in early December to discuss further issues not on the agenda and to vote on recommendations.

PRESENTATIONS

State Compensation Ranking and Market Comparison – Arizona Department of Administration (ADOA)

Kathy Peckardt, Assistant Director, Human Resources, ADOA, stated that members of her staff were present to answer any technical questions; namely, Joanne Crew and Bob Dyer from the Classification Compensation Unit of the Human Resources Division. Ms. Peckardt commented that the State faces a difficult challenge, noting that State agencies have already reduced staffing levels and placed higher demands on existing workers. She indicated that as of June 30, 2003, the State's workforce has decreased by 1,200 employees, which is the first significant decrease in recent years. She presented workforce statistics of State employees as follows:

- Currently there are 37,293 covered and uncovered employees, and of that number, 87% are covered employees.
- Average age is 44.1 years, compared to the national average of 44.5 years.

- Average length of service is 8.1 years, compared to the national average of 11.2.
- Current turnover rate is 15.4%, and 13.1% of that number left voluntarily.

Ms. Peckardt discussed employee compensation as outlined in her handout "State of Arizona ADOA Advisory Recommendation" (Attachment A). One of the highlights was the fact that the State's employee salaries continue to fall significantly below all other market wage indicators.

Ms. Peckardt stated that ADOA annually conducts a Western States Salary Survey, which compares salaries for positions that are unique to the public sector. The current survey shows that Arizona is 21.3% below market. She pointed out that the most widely referenced tool used by ADOA is the Joint Governmental Salary Survey, which assesses where State employees are in relationship to the Arizona market. This survey represents a very broad cross section of private and public sectors with 188 participants and indicates that this year State employees continue to lag the market by 16.3%.

Ms. Peckardt referred to the last page of the handout, which provides a comparison by occupational group, noting that those behind in the market are in the areas of technical, professional/administrative and clerical. She explained the various pay grades and ranges, as well as comparing them with the local market. She stressed that over 80% of State employee salaries are below the mid-point of their range.

Ms. Peckardt commented that the survey also compared State employees' wages with those of nine Arizona cities and noted that the State is significantly behind the average of those cities salary programs. She indicated that page 9 of the handout shows some recommendations listing three model approaches. She pointed out that one of the recommendations of this Committee was to be within 5% of the market, noting the costs associated with that recommendation. She commented on other alternative recommendations that would not be as drastic, such as performance recognition and non-compensation based options.

In response to Senator Leff, Ms. Peckardt commented on covered and uncovered employees. She clarified that the average salary of $31,800 refers to covered employees only and explained how the survey compares similar positions with other states. Further discussion took place on covered and uncovered positions in the survey.

In response to Mr. Williams, Ms. Peckardt explained the decrease of 1,200 positions in the State's workforce. Representative Huppenthal further explained the reasoning behind the decrease, noting both negative and positive effects within agencies as a result of the decrease. He commented that the Joint Legislative Budget Committee (JLBC) conducted an analysis comparing Arizona with other states to determine the burden on taxpayers to support State government payroll costs and discovered that Arizona is number two in the nation with the least burden on taxpayers. He pointed out that to a certain extent a beneficial effect has been that the burden to taxpayers has been lessened, while at the same time employees are still accomplishing the necessary work. He stated that while there are positions "open," there likely are no funds to hire people to fill those positions.

Ms. Burton Cahill asked whether there is an analysis or study regarding costs to the State with respect to training when employees "opt out" or leave State employment. Ms. Peckardt responded that a study has not been conducted within the ADOA personnel system; however, there are numerous studies available indicating the costs involved in training. Ms. Burton Cahill suggested that it would be difficult to reach a definitive conclusion without that type of information as it applies to the State.

In response to Mr. Bell regarding job ranges, Ms. Peckardt said that in the private sector, it typically takes approximately six years for an employee to reach mid-point of the salary range. In contrast, that progression takes approximately ten years for State employees to reach mid-point. She noted that last year's Advisory Recommendations by ADOA included suggestions to move employees through the ranges. She stated that those suggestions were not included in this year's study due to the condition of the budget. Mr. Bell suggested that perhaps a mechanism could be created to enable employees to move systematically through the ranges either by merit or performance increases. Ms. Peckardt responded that she believes that would be an excellent idea.

In response to Senator Leff, Ms Peckardt replied that a study could be conducted to compare uncovered employees with other states and governments as was done with covered employees. She also explained the differences and benefits between covered and uncovered employees. Senator Leff said it appears that there is an imbalance with respect to the covered and uncovered employees. Ms. Peckardt responded that ADOA does not have any statistics as to pay for uncovered employees. She noted that there are certain benefits associated with covered employees that uncovered employees do not have through the merit system, such as the ability to grieve or to undertake an appeals process upon dismissal or demotion. She said there is also a "reduction in force rights" benefit for covered employees during times of layoffs. Ms. Peckardt commented that there are also benefits for uncovered employees such as the ability to pay an employee within the pay range of that uncovered position. Another benefit is an uncovered employee is able to accrue annual leave at a higher rate similar to a covered employee who has been in State service for fifteen years. She said she would be happy to provide additional data for the Committee.

Representative Huppenthal commented on a study that he undertook recently comparing State employees' compensation of five years ago to the current year. He suggested that the Committee should do further sophisticated work on this type of study centered around retirement records and turnover rates. He said a budget mechanism technique is needed to protect the wages for critical front line workers, such as Child Protection Services (CPS) workers and correctional officers so those monies are not siphoned to other areas.

Ms. Strock commented on the covered versus uncovered position issues, indicating that she has seen charts showing where employees fall within their range by grade. She asked whether data could be provided on the distribution levels of the pay ranges for State employees. Ms. Peckardt responded that ADOA could provide that information to the Committee within the next two weeks.

Mr. Williams commented that he believes the mission of the Committee is to find a vehicle to bring State employees within 5% of market irrespective of the turnover rates and other factors. He said the "pay step" program is a positive means to accomplish that mission. Representative Huppenthal clarified that he did not want his comments to be misconstrued as being critical of State employees. He explained that his main point is that the data indicates Arizona ranks number two of the fifty states in providing the best value to taxpayers. Senator Leff clarified she also is not critical of State employees; however, she is struggling with the covered versus uncovered position issue.

Mr. Bell referred to salary increases and commented that ADOA is required to distribute those funds to employees as dictated by the Legislature, such as the special salary plan for correctional officers. He stated that there is no current mechanism for State covered employees to move through the salary range, which has been a problem.

Ms. Tenney commended Ms. Peckardt and the ADOA staff for the excellent report. She indicated that there is a high level of turnover from agency to agency, and asked whether there is any data showing the true turnover rate between agencies resulting in excessive employee training. Ms. Peckardt responded that the 15.4% figure in the report represents people leaving State service. She said the return figure is not available at this time, but is hopeful that the new system to be utilized next January will include better data of the workforce than has been available in the past. Ms. Tenney said she recently transferred to the Arizona Department of Corrections (ADC) and noticed that "band aid" compensation remedies are creating inequities within ranges. She asked whether any plans are being made to review specific inequities within the system as a whole. Ms. Peckardt responded that the "band aid" process has been in effect for a number of years, and until sufficient funding is available to address that problem, the "band aid" process will continue.

Ms. Bayless explained that when the merit system was created, there were grades and steps within each grade. She said the idea was to move people along and make managers manage better. However, the system was not funded adequately. She said in the earlier years, employees were paid close to market, and there was not the turnover rate as exists today. She commented that adequate mechanisms and funds are necessary to move people through the ranges to correct the problem.

Mr. Nau commented that Maricopa County experienced the same problem in the past. He talked about a study conducted by the Hay Group, known as the "Hay Study" which revealed that the main problem was the lack of movement within ranges. As a result, Maricopa County instituted a program that enabled department directors and management teams to have more authority and discretion to move people within the ranges based on mixture of both market and personal performance. He mentioned that the program has served the County well and has presented an opportunity for the County to train managers with little funds. As a result, the County's turnover rate dropped from well above 20% to below 10% by 1999. He said no new increases have been funded during the last two years; instead, the County has utilized one-time incentive-type payments. Mr. Nau commented that he feels that having a system that allows management discretion to move people through ranges is the best solution.

Mr. McGuire stated he wanted to follow-up on the comments of Ms. Bayless and noted that the chart in the handout indicates how far the State has fallen behind since 1987. He said in 1987 there was a policy decision by the Legislature to move an automatic nonperformance-based increase model to a performance-based increase model. However, he explained that there was a lack in that policy decision of a substitute mechanism to force the annual funding of the salary increases which caused the gradual erosion of State pay. Subsequently, this Committee was created in an effort to get the process back inside the budget cycle. He said it is important for this Committee to send the message to the Legislature to have salary increases in the form of a step system put back inside the budget process at the front-end rather than at the back-end of the process.

Senator Tibshraeny asked Ms. Sapien to comment on the suggestions and recommendations that have emanated from this Committee in the past few years. Ms. Sapien explained the recommendation reporting process and indicated that in the past couple of years recommendations were made to move salaries within 5% of the market.

Senator Leff stated that the study suggested by Representative Burton Cahill may be the perfect place to focus on the cost of training of new people. She suggested that it may be discovered that it would not cost more to implement the step program than it would to continually retrain employees.

Mr. Maguire commented that prior to the elimination of the step program, there were years in which the Legislature did not fund it. He explained that the step system versus the merit pay for performance is a policy choice and has nothing to do with funding. Mr. Maguire referred to the tenure issue and explained past patterns. Ms. Peckardt referred to a chart reflecting those employees leaving State service (Attachment B), and explained that detailed information is available in the Annual Report on ADOA's website. In response to Representative Huppenthal, Ms. Peckardt explained the turnover rate.

Ms. McGonigle pointed out that a report from the universities is being prepared, which should be completed by October. She noted that much of the same problems exist at the universities with high turnover rates and salaries behind the market. She indicated that a major problem occurs with not being able to move the employees through the ranges.

Ms. Strock commented that the costs of turnover are very significant and should be reviewed by this Committee. She said it is very important and relevant to look at total turnover, both external and internal.

Mr. Nau said another relevant issue is how much is actually being funded in terms of increases. He indicated that internal turnover affects both the training costs and how much is given in raises. He emphasized that it is important to have a compensation strategy that optimizes available dollars and increases efficiencies.

Ms. Burton Cahill mentioned that it is important for the Committee to address how the level of service can be raised in positions without having any cost increases.

Mr. Maguire stated that the current situation is counterintuitive, and he would like to suggest that the Committee make a recommendation to the Legislature that is different than what has been done in the past. He pointed out that perhaps a recommendation should be made for a system that grants greater discretion to managers such as is used in Maricopa County because the current State system is not working.

Senator Tibshraeny asked staff to assemble a list of recommendations for the next meeting based on members' input.

Representative Huppenthal stated he does not agree with the idea that this Committee has not had any influence in the past. He brought up the pay increase granted in 2002, which was probably a result of the Committee's recommendations. He mentioned that the work of the Committee is vital and believes the members should reach for a higher sophisticated level in its task. He emphasized that it is important to note that the Committee exists to serve the citizens of Arizona. He pointed out that the resolutions to these issues should be accomplished in the least expensive way, while at the same time treating State employees fairly. He indicated that it is critical that the Committee examine the groups of people where there is a 20% to 30% turnover and provide management more flexibility to manage pay classifications. He added that he feels they should carefully structure the recommendations so that managers are not taking money away from the frontline workers and rewarding those in higher powered positions.

Mr. Nau noted that DOA has not had the opportunity to analyze the data because of the problems with the Human Resources Information System (HRIS). One element the Committee should review is the average evaluation score of an individual who is leaving the system. The evaluation system should be designed so that the employees with low evaluations are not rewarded with a pay increase, which hopefully encourages them to improve performance or leave employment. Those who are doing an exceptional job, and their evaluations clearly identify good performance, should be rewarded.

Senator Tibshraeny explained that there are certain things the Committee can review such as the step system and optimizing efficiency. It will not be a simple task because of the funding issues that will need to be addressed. He noted that one of the first items to take care of is to extend the Committee, which expires December 31, 2003.

Senator Leff wondered about employees moving from one grade to another and should it be an easier process to ensure advancement opportunities. Ms. Strock replied that in the private sector, employees advance through the salary ranges as performance warrants; however, there are no opportunities to do the same thing in the government sector. She stressed that if managers had the tools to reward performance and allow employees to move through the salary ranges, it would be a huge improvement in the system. Mr. Nau explained that previously in the county government group, when an employee shifted from one grade to another, they essentially were changing jobs. They eventually eliminated the grades and now have approximately 250 salary ranges that apply to 14,000 positions. He added that there is a philosophy as to how long it should take an employee to advance from the beginning to the maximum position.

Ms. Bayless suggested that some government areas do better with career ladders than others. New employees should have a good idea of what the career ladder involves. If an employee achieves, they would be able to follow the career ladder, which would provide opportunities to advance through the salary grade.

In response to Senator Tibshraeny, Ms. McGonigle distributed a handout (Attachment C) regarding cash and noncash incentives. She briefly discussed the noncash incentives that the Committee could consider: 1) workweek flexibility; 2) additional holiday; 3) university tuition assistance; 4) voucher system; 5) discounted auto/home insurance; 6) discounted auto license tag fees; 7) free bus passes; 8) paid sabbatical; and 9) no state income tax on W2 earnings.

Joe Masella, President, Arizona Correctional Peace Officers Association (AZCPOA), provided a handout (Attachment D) entitled The Forgotten Cop. He explained that merit increases open the door to allow some supervisors to take care of their friends. He brought up that New York correctional officers have a pay scale that does not take half their career to advance through. In Arizona, after nine years of employment, a corrections officer can reach the top of the range of $35,000, which is the midpoint of comparable jobs in the State. He suggested that the Department of Corrections should be reviewed differently than other positions in government. He noted some statistical data that supported his theory of decreasing turnover, pointing out that it would cost the State less to provide increases to current employees rather than training new staff. He added that 70% of the correctional staff have been on the job for less than 18 months. He suggested that pay scales could be restructured and top-ranked positions could be combined to assist in providing funding for salary increases.

Senator Leff noted that often when new money is available in the budgets, the administrators get the bulk of it, rather than compensating the frontline employees. She agreed that the top ranked individuals should be paid what they are worth; however, there needs to be a procedure in place to consider frontline employees first for salary adjustments.

Mr. Williams said that in his experience, every employee has a job and function with a workload that is required to meet the standards established. He stated that he has advocated that there should be just compensation for everyone within the career ladder.

Representative Huppenthal asked staff to provide information as to how many classifications exist in State government, turnover rates for positions, and the average pay increase associated with an internal turnover. He also mentioned that he feels there should be a way for the State to pay for the Employee Appreciation Lunch rather than the employees paying for their own lunch.

There being no further business, the meeting adjourned at 11:40 a.m.

Respectfully submitted,

Nancy L. DeMichele, Committee Secretary

(Tapes and attachments on file in the Secretary of the Senate's Office/Resource Center, Room 115)

Research

ARIZONA STATE LEGISLATURE

JOINT LEGISLATIVE STUDY COMMITTEE ON STATE EMPLOYEE COMPENSATION

Minutes of Interim Meeting
Wednesday, December 3, 2003
1:30 p.m. - Senate Hearing Room 109

Chairman Tibshraeny called the meeting to order at 1:35 p.m. and attendance was noted.

Members Present

Senator Jay Tibshraeny, Cochair
Senator Marsha Arzberger
Senator Barbara Leff
Representative Marian McClure
Jessica Anderson
William Bell
Leigh Cheatham
Geri Davis
Cathy McGonigle
Kathy Peckardt
Linda Strock
Pam Tenney
Carl Williams

Members Absent

Representative John Huppenthal, Cochair
Representative Meg Burton Cahill
Betsey Bayless
Shawn Nau

Staff Present

Nadine Sapien, Senate Government Committee Analyst
Michael Huckins, House Government and Retirement Committee Analyst

Presentation of Total Compensation – ADOA

Kathy Peckardt, Human Resources Director for the Arizona Department of Administration (ADOA) stated the ADOA contracted with The Segal Company to determine the market competitiveness of State employee total compensation and introduced Mr. Susseles.

Elliot R. Susseles, Sr. Vice President of The Segal Company, presented the results of the 2003 Total Compensation Study (Attachment A), which he indicated is a cost-based study of State employee pay and benefits compared to other employers.

Mr. Susseles cautioned the Committee that when a comparison is made regarding benefits and costs regarding health and dental insurance, it is affected by several factors such as co-pays, deductibles, and actual utilization. He also noted that contributions to retirement plans are a function of plan design, work force demographics, asset valuation methods, and the degree to which plans may be over or under funded.

Senator Arzberger expressed concern that a 1998 study found the State was 16% behind and that it is now 23% below the market.

In response to Mr. Williams, Mr. Susseles said the Study looked at actual average pay and compared that with what other people with similar jobs would be paid and the gap was significant on all levels of the pay range.

In response to Representative McClure, Mr. Susseles indicated the State needs to review the demographics of its work force and cautioned that as baby boomers move closer to retirement, the State will be facing market competitiveness and will have to increase starting salaries in order to attract new employees.

In response to Mr. Williams, Mr. Susseles stated that typically in the private sector automatic pay raises are not built in. He added that a recent study indicated there is a significant number of people employed in the private sector who genuinely plan to move to new employment once the economy improves.

In response to Mr. Bell, Mr. Susseles indicated the benchmark of 23% includes benefits and the 24%-29% represents pay alone. He added the objective of the study was to look at how much employers are spending for similar jobs compared to the State. He indicated a study that would take into account the nuances of the value of different benefit plans would have been a much more extensive study requiring more time than was available to accomplish this study.

Update on Status of Self-Insurance – ADOA

Ms. Peckardt explained the State began looking at self-insurance several years ago and the Legislature mandated that ADOA go to self-insurance by October of 2003, however, ADOA asked for a three-month to a year delay and the Legislature directed that self-insurance not be implemented during fiscal year 2004. She stated ADOA now has real data, based on the review and evaluation of the RFPs, which clearly indicates that self-insurance is financially good for the State.

Stephen Shram, Lead Consultant for Mercer Human Resource Consulting, distributed a document on self-insurance (Attachment B), which provides an update on the State's desire to move toward self-insurance. He stated that in examining the options, self-insurance is an excellent opportunity for the state to make progress from both financial and operational perspectives.

Mr. Shram indicated self-insurance is very successful in other states, is only directed at financing, and does not change the way benefits are accessed or plan design. The contracts are set up with a single, third party administrator who acts as the integrator for the contract vendors, as well as a single contractor for pharmacy benefit management, utilization review, and stop loss. There will be more physicians and network choice in both urban and rural areas.

Mr. Shram indicated the cash issues associated with the cost of self-insurance have been accounted for and the compelling reason to go to self-insurance is the State's ability to take control of the program and customize it to State employees.

In response to Senator Leff, Mr. Shram explained the multi-vendor approach has been used across the country as well as in Arizona and the way the RFP was structured was that any one RFP could not be contingent upon another, which the Procurement Code does not allow. Mr. Shram clarified it is not against the Code to "bundle", but it is against the Code to have individual contracts contingent on each other. He indicated the RFP did not preclude the large companies from bidding, but rather those companies made a business decision not to bid. He stated he did not believe a new RFP would be within the best interests of the State.

In response to Senator Leff, Mr. Shram said the State has no intention of attempting to avoid any of the legislatively mandated benefits or protections that are in place.

Senator Leff raised concern regarding the reserve and what happens if there is a catastrophic situation and the money is not available to cover those losses. Mr. Shram indicated protection would be through the stop loss insurance, which has an approximate cost of 1% to 3% of the risk.

In response to Senator Leff, Mr. Shram said the vendors the State has received RFPs from are not working only with AHCCCS or Workers' Compensation, but are companies that currently provide self-insurance for large and small private employers in the State, including eleven of the State's fifteen counties and some school districts.

Senator Leff expressed concern regarding the appeals process and questioned whether the third party administrator and the medical network would be the same entity. Mr. Shram indicated it was possible they could be the same, however, the proposal is to use a single third party administrator on a statewide basis and multiple medical networks so that does not happen.

In response to Senator Leff, Ms. Peckardt, said ADOA is now implementing the communication part of self-insurance by meeting with legislators and other groups. They will have to go before the Joint Legislative Budget Committee to review the contribution strategy before they can make an award.

In response to Mr. Williams, Mr. Shram stated six different RFPs went out and were distributed to approximately 300 companies nationwide. He noted bundling allows a more integrated approach for information and they believe integration is not a material difference between self-insurance with a multi-vendor and with a bundled approach.

In response to Representative McClure, Mr. Shram said some states have built their reserves over time and some states have not set aside reserves at all and run their programs purely on a cash basis. ADOA review indicates there is a wide range of reserving approaches and he stated he would provide her with a copy of the review. Mr. Shram indicated, short of a constitutional referendum, there is no guarantee or safeguards against the State taking the money and putting it into the General Fund.

Presentation by CIGNA

Steve Barclay, lobbyist for CIGNA introduced **Jeff Terrill, President of CIGNA Healthcare of Arizona.** Mr. Terrill distributed a document entitled "Joint Legislative Committee on State Employee Compensation – Self-Insurance Bidding Process" (Attachment C) and stated that CIGNA provides services to nearly 25,000 State employees and dependents.

Mr. Terrill offered the following corrections to Mr. Shram's statements:

1) The first year renewal was 14.9%, not 19%.
2) The second year CIGNA offered 19% and was willing to negotiate, but the State was not.
3) CIGNA's medical loss ratio is approximately 88%, not 81% and, of the remaining 12%, 2% goes to state premium tax.
4) CIGNA's expense is approximately 10%, which is substantially less than the 14% projected under self-insurance.

Mr. Terrill indicated CIGNA was selected based on it's quality, service, financial stability, best value plan, and benefit options at the lowest cost for employees statewide. It has the largest rural and urban provider network, the highest employee satisfaction rating at 90%, the lowest complaint ratio and number of appeals, and the highest clinical qualify ratings of all plans. He stated it is important to note that while many other states have multi-vendor options, they do not have multi-options by function.

Mr. Terrill indicated that the point of service option will be eliminated causing 5,000 State members to lose their current choice. The Medical Plus Choice Program will be eliminated, causing 1,800 State retirees to lose their current choice. CIGNA medical group provider network will be eliminated causing 25,000 State members to lose their current physician of choice. He stated the October 2004 renewal maximum is 13.3%, which is $17 million less than the self-insured proposal.

Mr. Terrill stated the key competitive differential is that there are millions of members with CIGNA, not hundreds of thousands, and superior provider agreements and contracts are achieved by having that volume. He concluded that CIGNA is interested in continuing to serve the State of Arizona and is willing to provide the support for a reduced rate for the fourth quarter of 2004 if the State needs more time.

Presentation of Performance Pay Measures

Senator Tibshraeny said he would hold off on this presentation for right now because the Committee members had to attend Caucus at 3:30. Information was distributed regarding the Performance Incentive Program (Attachments D and E).

University Salaries

Kathy McGonigle, Arizona Board of Regents, distributed the Annual Personnel Report for the Arizona University System (Attachment F). She stated that there are serious salary issues with the Universities, which are substantially behind the market and the gap keeps getting bigger. Turnover rates are high and the estimated unmet salary needs for fiscal year 2005 will be approximately $179 million to achieve market competitiveness. She noted that State law requires that university salaries be within 5% of market compensation, including benefits.

Senator Leff stated the upper level salaries at Arizona State University are extremely high, which are in line with private universities with large endowments. Ms. McGonigle indicated there is an effort on the part of the Board and the universities to keep within a range of average salaries of peer institutions, but recruitment is conducted in the national market and top executive salaries in those universities are relatively high. She stated each of the three universities have tried to reallocate dollars within the institutions to try to provide salary increases to faculty and staff and have done so over the past year, however, more money is necessary to correct the inequities.

Consideration of Recommendations

Senator Tibshraeny offered a recommendation to introduce legislation to continue the mission of the Study Committee.

> **Senator Arzberger moved the recommendation that legislation be introduced to continue the mission of the Committee, which sunsets on December 31, 2003. The motion passed by voice vote.**

Senator Tibshraeny stated a recommendation should be made to the Governor, the President of the Senate, and the Speaker of the House of Representatives to increase the salaries of State employees and referred to the memorandum from Betsy Bayless and Kathy Peckardt (Attachment G), which provides different scenarios for bringing salaries current.

In response to Senator Leff, Senator Arzberger explained the problem with the last State employee budgeted increase. The budget started out including a 5% increase for State employees and then things went bad and it was reduced to 2.5%. The problem worsened when the employee contribution for health care and retirement increased more than the salary increase.

Mr. Williams stated he has been on the Study Committee for five years and the original goal was to make recommendations to the Legislature to bring State employees to within 5% by this year. The documentation shows it has only come forward 1.5% in that five-year period and if projected another five years, it will only be 3%. Referring to the memorandum, he stated he would prefer model 1, but would support model 2.

Senator Leff stated the last battle regarding salaries was during a year when there was no money and people would actually lose jobs if raises were given. She cautioned that the State still may need to be conservative until a year when the money is available.

Senator Tibshraeny stated that when you do not pay people a fare wage there is a great increase in turnover and it ends up costing more in production and lost expertise. We need to send a message that employees need to be prioritized.

Referring to the memorandum, Ms. McGonigle stated that the models are basically the same except in model 2 there is a 4.2% increase each year. Model 3 is more conservative and gives a 2% increase each year as the economy improves. Senator Leff clarified that the increase would be for fiscal year 2005, not 2004 and recommended model 3, considering how bad things are right now.

Senator Tibshraeny stated he thought the recommendation should be for both models and give the option to the Governor, President, and Speaker.

Senator Arzberger stated the recommendation should include that the Committee has the intent to commit to bringing State employee pay to within 5% of market by fiscal year 2009.

Ms. McGonigle suggested the recommendation include the total need as well as the two models.

Mr. Williams emphasized the need to keep the employee benefit contribution low with these models.

Linda Strock suggested making a compromise between model 2 and model 3 and start the second year with 3% rather than 2%, because of the budget. That would minimize the initial expenditure and would make a stronger statement.

Mr. Williams referred to the pay steps and said they contribute to longevity on the job and provide a core of employees who will stay for the long haul. Senator Leff concurred that should be included in the recommendations. Ms. Peckardt indicated it is included within the 3 models in the memorandum.

Ms. McGonigle suggested providing special market adjustments as part of the recommendation. Ms. Strock agreed that the need for special market adjustments is critical and she would like to see a comprehensive approach so as not to create negative morale.

Senator Arzberger moved that the Committee recommend that a model be developed to give salary increases to State employees beginning in fiscal year 2005 with a 3% increase and increasing the percentage until the target amount of 95% of market is reached by fiscal year 2009. The recommendation shall include a mechanism to move employees through the salary range and that the Committee renew the commitment of the State to bring the State employees' pay to within 5% of market by fiscal year 2009 and an avenue be established for special market adjustments. The motion passed by a voice vote.

Senator Tibshraeny instructed the staff to transmit the recommendations to the Governor, the President of the Senate, and the Speaker of the House of Representatives and adjourned the meeting at 3:45 p.m.

Respectfully submitted,

Rosetta B. Cutty

(Tapes and attachments on file in the Secretary of the Senate's Office/Resource Center, Room 115.)